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CIVIL SERVICE PENSION REFORM ACT

A REPORT

PREPARED BY THE

SUBCOMMITTEE ON CIVIL SERVICE, POST OFFICE, AND GENERAL SERVICES

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

DECEMBER 1982

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COMMITTEE ON
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WASHINGTON, D.C. 20510

December 1982

Dear fellow employee:

Our retirement system has come under increasing attack in recent years. Many of the benefits we once enjoyed no longer exist. I believe this attack will continue to the point where the retirement system's benefits will be emasculated, unless we come up with an alternative. Recall the past benefits such as the 1% kicker, the look-back formula, the twice-a-year cost-of-living adjustment, and the full adjustment at any age of retirement. They have been either changed or repealed. Note also that as of this month we will be paying the Medicare tax.

We anticipate that federal employees will be placed under Social Security soon, a move I have opposed. However, when that occurs, I believe we should turn this loss into a net gain for federal employees. For that reason, I have suggested an alternative--to establish a new system for new workers, which current workers may join, while leaving the current system intact for all current workers who prefer to remain in it.

The new system should be less costly and more closely patterned after private sector plans. In this way, the new system will not be subjected to cost-cutting necessities. Establishing such an alternative system may be the only way to protect the current system from further substantive change.

Until a majority of those affected by this proposal support it, I will not pursue the passage of this legislation. What follows is a detailed explanation of the proposal. I hope you find the information helpful.

With best wishes,

Cordially,

Ted Stevens

TED STEVENS
Chairman

LETTER OF TRANSMITTAL

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
SUBCOMMITTEE ON CIVIL SERVICE,
POST OFFICE, AND GENERAL SERVICES,
Washington, D.C., December 9, 1982.

Hon. WILLIAM V. ROTH, Jr.,
Chairman, Committee on Governmental Affairs,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Subcommittee on Civil Service, Post Office, and General Services transmits the following analysis of my bill to establish a new federal employees retirement system.

Because of the recent changes and increasing future threat to the current Civil Service Retirement System, we have formulated an alternative pension system, closely related to the private sector, to provide a more secure, stable, and financially rewarding program for the federal worker. This new program would be for new federal employees and for those in the current work force who elect to participate.

Naturally, any proposed changes that at first glance appear threatening are a cause for overwhelming concern. In presenting these proposed changes to concerned federal employees, we have developed a series of extremely informative position papers describing in detail the legislation's three tiers of retirement benefits. This has been a critical factor in informing the federal employees of these proposed changes.

The requests for information on this proposal have been tremendous in volume. In order to respond to these requests, we have compiled an analysis to help inform the Members as well as other federal employees of information necessary for making a decision on such an important matter.

Therefore, I request that the Committee on Governmental Affairs issue a committee print of the enclosed analysis in order to better and more economically disseminate this information.

Cordially,

TED STEVENS,
Chairman.

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I. DESCRIPTION OF LEGISLATION

INTRODUCTION

Retirement spells drastic changes for individuals and families. Income drops. Priorities change. A second life begins. Prior to retirement an employee makes a variety of decisions affecting his future. The most important questions are what will he do; when will he retire; and how much income will be needed to meet the needs of himself and his family.

Unlike 25 years ago, today an employer must offer a retirement plan to attract quality employees. A good retirement plan offers to resolve in part the questions of a reasonable retirement age and a sufficient income level. To determine these and other specifics, an employer must consider a number of factors, such as:

1. What can be profitably offered?
2. What benefits are competitive with counterpart businesses?
3. How much employee turnover is desirable?
4. What age range is necessary or desirable for the type of work involved?
5. What requirements must be met under the Employee Retirement Income Security Act of 1974?

The Federal Government as an employer, however, is faced with a different set of circumstances. The government's provision of a secure retirement for its employees is counter-balanced by its responsiveness to the taxpayers. While employee benefits in a business are constrained by the profit margin, similar benefits in goverment employment are constrained by the public's willingness to pay. The government has a responsibility to both groups to provide a good yet affordable retirement plan. The current Civil Service Retirement System (CSRS) is clearly lacking in both respects. It is an expensive plan which rewards a few at the expense of many.

The Congressional Budget Office reports that annual outlays of CSRS are $17.3 billion and will rise to $30.1 billion in 1986. Total retirement costs constitute 36.8 percent of payroll, of which 29.8 percent are government costs. This is to be compared to typical private sector plan costs of 22.7 percent. Yet, these high costs reflect benefit payments to a relatively small group of people. Studies show that approximately 25 percent of new federal hires remain in the government until retirement. The remaining 75 percent either withdraw their contributions upon resignation with little or no interest accrual or they remain vested in the system to receive a marginally smaller retirement benefit upon reaching retirement age. Hence, the exorbitant costs of the current system result from the relatively few who take advantage of it.

We are convinced that the cost of the system can be significantly reduced while redistributing the benefits to profit the most. In order to do this in the most equitable manner, we have introduced

a bill to establish a new retirement system to mandatorily cover all federal employees hired after the date of enactment of this legislation with the option to current federal employees to elect coverage under this new system. This legislation, the Civil Service Pension Reform Act, will dramatically change the pension system for federal employees.

It includes social security coverage for all new federal employees. Social security will be the foundation for the rest of the system. It will make the system comparable to pension plans in the private sector. The public will no longer have reason to single out federal workers as ones insulated from their concerns. All will be treated equally here. Yet, even to the federal worker, the benefits of social security coverage far outweigh the liabilities.

The basic pension plan will be a defined contribution plan requiring government contributions only, eventually to be invested in the private sector. One's retirement will depend upon the accumulations of his contributions plus its investment earnings. Private investment provides a variety of heretofore unavailable options. Individual employees will now participate in investment decisions. When an employee feels his account is sufficiently large to support him, he can leave at any time.

Most federal workers will actually benefit from this new system. Actuarial estimates reveal that employees at all income levels who work a full career will receive greater net replacement of their income (after taxes) than under the current system. The new system will provide employees with portability between the federal and private sector, non-existent now. An employee may leave after five years, taking with him his accumulated earnings and his social security credit. This option heralds a new flexibility for federal employees. Retirement benefits will no longer direct the decisions for mid-career federal employees who are considering other career alternatives. The retirement plan will continue to reward full career federal employees while freeing part career employees to move in and out of the non-federal sector.

In addition, unfunded liabilities and spiralling government costs will be problems of the past. The system will be fully funded. The government's costs will be fixed. This system also achieves substantial cost savings over the current system. The new system reduces the cost of federal retirement to the government, and thus to the taxpayer, by 20 percent. These savings are achieved primarily from three places. First, coverage by social security precludes the generation of disproportionate benefits to those who work in covered employment for short spans. Second, those who take advantage of the current system by retiring with minimum age and service eligibility will no longer receive benefits commensurate with the current arrangement until age 62 when social security payments begin. Third, cost-of-living increases are funded through private investment, rather than government largess.

Admittedly, the concepts contained in the legislation are somewhat revolutionary vis-a-vis the current system. However, such retirement plans are fairly common in the private sector. The structure, the costs, and the benefits are comparable to many good private sector retirement plans. The following describes the bill's general provisions:

1. The proposal mandatorily covers all federal and postal employees hired after the date of enactment.

2. There is an option for current workers to elect coverage in the new system.

3. The government will buy an employee's current retirement credit for the employee who elects coverage in the new system. The new amount will be placed in the employee's account in the new system. The employee will have two options:

(a) The worker's current retirement contributions will be matched by the government with the total increased by a 5-percent interest factor compounded for the number of years of service, or

(b) The worker will be entitled to the present value of his accumulated benefits adjusted by a 6-percent inflation factor.

The following table illustrates the amounts involved for an employee who entered government service at age 25 with a starting salary of $10,000 and received annual pay increases of six percent. Option A is based on a 5-percent interest rate. Option B is based on a 6-percent discount rate and an assumed 6 percent inflation rate.

At age—	Option A	Option B
30	$9,104	$4,421
35	23,806	17,219
40	46,692	50,135
45	81,424	125,279

4. The first tier of the new system will be social security. Federal employees will pay the same social security taxes as covered employees and will receive the same benefits. The government will pay the employer tax and pay its portion into the social security trust fund.

5. The second tier will be a defined contribution plan. The government will contribute to an employee's account 9 percent of the first $20,000 (adjusted annually) and 16 percent for every dollar thereafter. This is a government contribution plan only.

6. The third tier will be a voluntary thrift plan. The employee may contribute any amount he wishes. The government will match 100 percent of the employee's contribution up to 3 percent of salary. In other words, if the employee contributes 6 percent, the government will contribute 3 percent; if the employee contributes 2 percent, the government will contribute 2 percent.

7. An employee will vest in the new system after five years of participation. This includes newly-hired employees and current employees who transfer to the new system. After five years of participation, an employee may leave government with the entire amount in his retirement account. This includes government contributions plus interest. Alternatively, he can draw an actuarily-adjusted annuity or he may defer drawing on the account until later in life. In such a case, the account would continue to accrue interest. Survivors will receive a social security benefit supplemented by the accumulated earnings in the employee's or annuitant's account.

8. The new system will contain a new pension fund. All government contributions to an employee's account in the fund will be in-

vested in special issues of the Treasury for the employee's first five years of participation. The employee's contributions to the thrift plan will be available for private sector investment beginning the second year. After an employee's fifth year of participation, all new government contributions will be available for private investment. During the first several years of the new system, however, government contributions to an employee's account after the fifth year of participation will be phased into private investment.

9. There is established an eleven person Federal Pension Board composed of the Secretaries of Treasury, Commerce, and Labor, the Chairman of the Federal Reserve Board, six appointments by the President (nominated to him by employee organizations), and an Executive Director appointed by the President with the advice and consent of the Senate. All Board members will be subject to the fiduciary responsibilities spelled out in ERISA. The Board will generally oversee investments of the fund. The Board will also establish a variety of investment options to which employees may direct their investments. Employees shall receive annual statements showing their current accounts and providing them with an opportunity to choose investments. The presiding member of the Board, one of the President's appointments, will be the Executive Director. The Director will implement the investments, contract with private investment firms, and perform general administrative functions.

10. A new sick leave and disability system is established. Each employee will be granted seven days of non-accumulating annual sick leave. Illnesses or injuries necessitating longer leave will trigger short-term accident and illness insurance. Such insurance will be preceded by a short waiting period and application for such payment must be accompanied by medical documentation. Depending upon one's length of service and the duration of his absence, an employee will receive 100 percent, 80 percent, and 60 percent of his gross pay.

If the absence will extend beyond six months, the employee may apply for long-term disability. If he qualifies for disability under social security, he will be guaranteed 60 percent of his gross pay until restoration or death. If he does not qualify for social security, he will remain covered for two years. After two years, he must take a fitness for duty examination or be dropped from the rolls. If he is considered capable of performing any federal job, he must be appointed to a position. If he refuses the position, all disability payments cease. If he is not able to perform any federal job but is still not eligible for social security, he will receive 40 percent of his gross pay until restoration or death.

11. The unfunded liability of the current system is amortized over a 40-year period by payments from the general Treasury. All agencies will pay the full cost of the employees remaining in the current system.

Social Security Coverage

In developing a proposal to restructure the Civil Service Retirement System (CSRS), we decided that social security should form the base of any new system. We recognized, of course, that coverage of even new federal employees under social security is an ex-

tremely volatile issue. (Our proposal grandfathers current workers and retirees in the current system.) Nevertheless, we believe social security coverage is a necessary part of any restructuring proposal and that most federal employees will find their overall benefit package improved.

Much misinformation has circulated concerning the issue of social security coverage for federal workers. Many employees apparently believe that the entire effort is motivated by a desire on the part of some officials to "bail out" a financially troubled social security system by draining the reserves of a financially sound CSRS into the social security trust fund. This is not true. While coverage of federal workers does enhance the financial status of the social security trust fund in the short run, the additional revenue will be largely offset by increasing eligibility for social security benefits as those individuals reach retirement age.

Besides, the reason the Civil Service Retirement Trust Fund is considered financially sound is due to the fact that the general revenues annually transferred to the fund from the Treasury subsidize the system. This is not true for the social security system. Some proposals for stabilizing the social security system include tapping the general revenues of the Treasury.

There are, we think, some basic considerations involved in the question of whether federal employees ought to be covered by social security.

1. The social security benefit is portable. Currently, the vast majority of those individuals who come to work for the federal government will leave federal employment and receive virtually no retirement benefit from CSRS. Social security coverage will provide these individuals with a continuity of service covered by a potential retirement annuity. Such portability should actually enhance the recruitment of some individuals who would hesitate to take federal employment because no such protection was being afforded.

2. Additional protections are found in the area of disability and survivor benefits. Those who currently leave federal employment without vesting in CSRS or who voluntarily withdraw from CSRS after vesting have no minimum disability or survivorship protection of any kind until they fulfill the basic requirements for social security coverage. With a social security based plan, such income protection will exist continuously regardless of job transfer. In addition, there is a greater dollar protection under the social security disability and survivor programs than under CSRS. This greater protection includes the family benefit attached to a wage earner's basic social security benefit.

3. The social security benefit is tax free. Currently, CSRS benefits are fully taxable once benefit payments equal the employee's lifetime contributions. This usually takes 18 months to 2 years. Social security benefits, however, are tax free from the first dollar. This is especially significant for wage earners at the lower grade levels, because a larger percentage of their retirement income will come from social security.

4. Social security coverage of federal employment would diminish resentment many citizens feel toward federal employees and retirees. Two reasons are often cited by citizens writing to Members of Congress about this issue. First, they do not understand why they

must contribute to and participate in the social security system while a substantial group of employees, including those who administer the social security programs and make decisions affecting it, are allowed to remain exempt. Second, they resent the fact that federal workers who acquire social security protection without having worked an entire career under social security acquire their social security benefits under especially advantageous circumstances. The social security formula enhances benefits for workers with low career average wages because of either low paying jobs or because of periods of time out of the work force. Federal workers who work short careers under social security covered employment receive the weighted benefit intended to provide the transient worker with a base income. This advantage is paid for by payroll taxes of all other workers.

5. Perhaps the most important benefit of social security coverage is the political one. The current exclusion of federal employees from social security coverage and the nonintegration of the CSRS with social security has left the CSRS open to political attacks. These attacks have been quite successful in recent years as demonstrated by changes in the cost-of-living increases. Currently, even deeper cuts in the CSRS are being considered in virtually every proposal designed to reduce the federal deficit.

The coverage of federal employees under social security and the concomitant integration with a civil service pension system will put federal employees in a comparable position with their private sector counterparts. They will become a part of a larger, more politically powerful group; i.e., taxpayers covered by social security. This political strength was demonstrated last year when significant social security changes were proposed and were almost immediately and unanimously rejected by Congress. This comparability will assuredly restrain the singling out of the civil service pension for cost-cutting exercises.

Defined Contribution Plan

Despite the news accounts of the extravagant retirement benefits awarded to federal workers, for most, the federal retirement system falls far short of true protection for the aged. Approximately 75 percent of a group of new federal hires receive little or no benefit from the current system because the Civil Service Retirement System is intended to provide adequate protection for only those employees working long careers in the federal government. Portability of benefits between the federal and non-federal sector is nonexistent. Once vested, there is still no guarantee that the annuity expected will be received. Federal retirement benefits are dependent upon Congress' annual willingness to maintain the ever increasing government funding of the system. In recent years, Congress has continually pared the level of benefits. It is likely Congress will continue to do so.

Our proposed pension reform, however, resolves in large part these problems. In addition to a first tier of fully portable social security credits, our approach provides for a supplemental pension that vested employees would own and could take with them if they left their federal jobs. It is this defined contribution plan, the

second tier of the new system, that is the major vehicle to accomplish the desired changes. The defined contribution plan will provide a supplemental pension to an employee's social security retirement benefit. Thus, a combination of social security and a defined contribution plan will form the primary basis for the employee's retirement income.

A defined contribution plan is significantly different from the currently structured defined benefit plan. A defined benefit plan is really a definition of eligibility together with a formula for the computation of benefits an employee receives when eligibility is acquired. The definition is subject to change by Congress at any time. A defined contribution plan is one in which a fixed percentage of salary is contributed by the employer to fund a worker's annuity, the size of which would depend on the sums accumulated in an individual's account. Federal employees covered by the new system would make no contribution to the defined contribution plan.

Under our proposal, the Government will contribute 9 percent of the first $20,000 in salary and 16 percent for every dollar thereafter. The contribution rates are designed to provide a very good retirement at age 65 with 40 years of service. For instance, under the current system, an individual with the above age and service receives 85–90 percent of his net preretirement earnings five years after retirement. Under our proposal, the same individual receives 90–100 percent of his net preretirement earnings by the combination of social security and the defined contribution plan. In addition, employees will have an opportunity to increase their net replacement rates by participating in a thrift plan (discussed fully in the next section).

The percentage contribution variance at $20,000 is designed to proportionately replace one's preretirement income at all income levels. This variance is intended to somewhat offset the skew in social security benefits. Social security, as a social insurance program, redistributes tax receipts to provide greater proportional benefits to lower income workers. By providing a variable contribution, the Civil Service Pension compensates for this social security distributive bias to more closely achieve a level percentage of replacement income at all income levels.

The government contributions to an employee's account will eventually be invested in the private sector. Thus, an annuity arranged with an individual will be dependent upon the contributions to his account plus the earnings. Another section discusses the advantages of private investment. Suffice it to say that a whole range of new opportunities are available to federal workers through the private investment option.

NEW FLEXIBILITY

As mentioned previously, most federal workers receive little or no benefit from the current system. The current system rewards employees who work for the government most of their lives. For those individuals, the retirement system is a great bonus. But for those who leave government before retirement age, the system is unrewarding. Employees who leave prior to retirement may choose to withdraw their own contributions with little or no interest or

leave the money in the system and draw a significantly lower annuity at retirement since it's computed on the salary they were receiving at separation. This dilemma often constrains employees from leaving government service, even though they may desire to. This phenomenon, known as the "golden handcuffs", not only hinders employee futures but builds a certain amount of unproductivity in the federal work force.

The new pension system alters this scenario. After five years of participation, an employee may leave the government and receive the entire value of all pension credits earned up to the point of separation. In effect, the employee will be able to choose one of three options: (a) a lump sum payment of the full value of earned pension credits; (b) a deferred annuity which would be based on the full value of credits earned up to the point of separation, plus any additional interest on those credits earned between separation and the date the annuity begins; and (c) an immediate annuity. Thus, under this plan there would be no age requirement. Any worker who stays for five years would reap a benefit earned under the retirement system, and in addition, would retain all social security credits earned through federal employment. The system is designed to provide a good retirement for someone who works until age 65 with 40 years of service, and younger in some cases; yet, under our plan, ones who choose to leave government earlier will no longer be penalized.

LEGAL RIGHTS

Regardless of the claims by federal workers that once vested their retirement benefit cannot be changed, it is clear that Congress has the authority to make changes in the system applicable not only to vested employees but also to current retirees. In the past few years Congress has repealed the 1 percent kicker, the "look-back" feature, twice-a-year cost-of-living adjustments, full cost-of-living adjustments at any age, and has changed the opportunity to take full advantage of a new cost-of-living adjustment to a method that prorates the first cost-of-living adjustment after retirement to reflect only the months since the annuity commenced. Congress will continue to consider other changes, further reducing benefits under the current system.

The courts have consistently upheld Congress' authority to modify government pensions. The Supreme Court has held that a pension granted by the federal government confers no rights which cannot be "revised, modified, or recalled" by subsequent legislation. Additionally, the court has ruled that until a pension is due, an employee's right is not contractural but a mere expectancy which can be revoked at any time. Hence, there is little certainty or security in the current system. Our proposal, however, is structured to remove the uncertainty of the current system and to actually establish currently vested property rights in the government's contributions to the pension fund.

Once an employee begins participation in the new system, an individualized account is opened for the employee. Contributions from the employing agency will flow through the employee's account into the directed investments. Those contributions will be

pooled with other employees' contributions and invested into various private and public instruments. Earnings on those investments will be continuously credited to employee accounts. Annually, the employee will receive a statement showing the principal and interest accrued in his account.

According to the legislation, an employee vests in the pension system after five years of participation. But unlike the current system, in which vesting simply means eligibility to receive an expected benefit, vesting in the new system means each employee owns and therefore has a right to receive all monies in that employee's account upon leaving federal service. In effect, because the employee's monies could be in part invested through private investment firms, the government would not be able to subsequently withhold any monies credited to the employee's personal account.

Once contributed to an employee's account, the monies become part of an investment portfolio administered under a quasi-contractural relationship involving the employee, the Pension Board, and the investors. The Congress, of course, could alter future contributions by legislation but could not tamper with the monies currently in the accounts. Therefore, an employee's pension will have far greater protection than now.

REDUCED COST AND FULLY FUNDED

In recent years there has been much bantering about the term "unfunded liability". Unfunded liability describes the difference between the expected obligations of the retirement system minus the expected receipts. It has resulted from the lack of government funding through the late 1960's, the cost of cost-of-living adjustments that are not paid for, certain retirement credit recognized for which no contributions are made, poor money management, and other reasons too numerous to mention.

The current unfunded liability is estimated to be $500 billion. As long as the government is willing to subsidize the system through general revenues of the Treasury, the system is financially sound. However, the cost is increasing annually as is reflected by this growing unfunded liability. These facts jeopardize the continuation of the current benefit level. The sheer immensity of these future obligations guarantees political attention that can only harm the financial integrity of the current program.

The cost of a current worker's expected future retirement benefit has climbed to 36.8 percent of pay. The worker contributes 7 percent matched by his employing agency. The remaining 22.8 percent is, in effect, an outstanding future cost. The only guarantee that his benefits will be paid at the level promised is Congress' willingness to allow this ever increasing demand for a general revenue subsidy to continue.

Our proposal resolves the issue of unfunded liabilities. The spiraling costs of CSRS will be brought under control. The government's future costs will be fixed. The total cost to the government will always remain a set percentage of salary which is easily recognized and predictable. Unfunded liabilities will never exist since the only government commitment will be the annual contributions to employees' pensions. In addition, as part of our plan, the un-

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funded liability of the current system will be amortized over a 40-year period. Hence, the current system will have adequate funding, and the threat to benefits under that system will decline.

As a result of our restructuring proposal, the government's cost for retirement for its employees will be reduced. Under the current system, the government pays approximately 29.8 percent of payroll; under the new system that cost will drop to approximately 22-23 percent, including the cost of social security. This reduced cost compares favorably to good private sector plans.

In conclusion, our proposed defined contribution plan, although transferring some investment risk to employees, contains a multitude of advantages—legal, social, and monetary—over the current defined benefit plan.

Thrift Plan

Using reasonable economic assumptions, an employee can retire under the first two tiers of our proposal at age 65 with 40 years of service with better benefits than under the current system. The third and last tier of this new system, a thrift plan, can ensure greater benefits, with the possibility of enabling an earlier retirement. Participation in this thrift plan is optional. Inclusion of the thrift plan in our proposal is designed to give the federal work force maximum flexibility in its retirement planning.

Thrift plans are a growing, popular feature of compensation programs in both the public and private sector. In fact, currently at least two federal agencies provide thrift plans to their employees—the Federal Reserve Board and the Tennessee Valley Authority. The plan proposed in this new system is comparable to those found in the private sector. These plans have proven to be an attractive addition from both the employer and employee perspective.

Under our system an employee may contribute up to 16 percent of pay with the government matching the first 3 percent. For practical purposes, most employees who participate will contribute 1, 2, or 3 percent of their pay which will be matched by the government. These contributions will be comingled with contributions to the defined contribution plan and will be invested in the private sector. However, employee vesting in the government contributions will occur more quickly than in the defined contribution plan.

In the basic pension, employees vest in five years. In the thrift plan, employees vest in a portion of the government's contributions after the first year. Vesting begins with 20 percent vesting after the first year, increasing by 20 percent each year until it reaches 100 percent after the fifth year.

The advantages of earlier vesting are considerable. Approximately one-third of all employees entering federal service leave government within the first five years. Because they have left prior to vesting, they cannot be eligible for a benefit. Under the current system, these employees receive refunds of all of their retirement contributions. Under the new system, the five-year vesting requirement in the basic pension also precludes those who leave before five years from receiving a retirement benefit. However, they have earned and will carry with them social security credits based on their federal employment, a refund of their own contributions to

the thrift plan, with interest, plus the prorated vesting in government contributions to the thrift plan.

The primary motive for the institution of a thrift plan is to encourage employees to save for their retirement. Traditionally, retirement income flows from three sources, i.e., social security, employer pensions, and personal savings. During inflationary periods it is difficult to save. A thrift plan is designed to attract reluctant savers and to grant employees additional options for retirement planning.

With the availability of IRAs, some may argue that the addition of a thrift plan is superfluous. We disagree. An IRA is most helpful as a limited tax shelter. Many, however, will find that the government matching contribution will be more beneficial than an IRA. This feature is not intended to dissuade the opening of IRAs but rather as an additional option for federal workers' retirement planning.

Funds in an IRA are tied up for many years. However, the Federal Pension Board (discussed in the next section), which manages this new system, is given discretion to establish loan arrangements with employees from their thrift accounts. A number of private firms who utilize these plans have similar loan opportunities. Normally, such arrangements are restricted to illness or significant financial commitments such as higher education. Thus, in general, the loan arrangement and the early vesting of the thrift plan make these funds more readily available to the participants.

Participation in the thrift plan significantly increases retirement benefits. For example, an individual at age 65 with 40 years of service would receive 90–100 percent of his net preretirement earnings without participation in the thrift plan. An individual participating sufficiently to garner the government's maximum contribution (3 percent of pay), would receive 110–125 percent of those same earnings.

In addition, participation in the thrift plan can afford earlier retirement opportunities. Under the current system, an individual who retires at age 55 with 30 years of service receives 65–70 percent of his net preretirement earnings. Under the new system, the same individual who does not participate in the thrift plan receives 20–35 percent of his net earnings at 55, and 55–67 percent with the onset of the social security benefit at age 62. Employees participating in the thrift plan will receive 31–50 percent of their preretirement earnings at age 55 and 67–81 percent at age 62. Thus, at age 62 the individual would be receiving greater benefits under the new system than under the current system.

Private Investment of the Civil Service Pension Fund

One of the more significant changes brought about by the Pension Reform Act is in the use of private investment rather than government securities for holding retirement assets. Private investment of retirement assets accomplishes several objectives we had in mind when we first began to consider reform of the current Civil Service Retirement System (CSRS).

Investing retirement assets outside government assures that the accounts upon which projected benefit levels are based cannot

become subject to budgetary restraint during economic hard times. The money to pay benefits will not be an available target in a period of budget cutting but will actually exist independent of the budget. Employees will know that they can count on the money for their benefits at retirement because they will actually own their accounts. These accounts will be able to earn interest in the private sector and will not be restricted to the low relative yields of federal securities. Finally, this investment method not only places the federal plan on a comparable footing with private sector plans, it actually increases money for much needed capital formation throughout the economy.

RATES OF RETURN AND INVESTMENT EXPERIENCE

Under the current system, all monies are required to be invested in federal government securities. Most of the holdings are in special issues of the Treasury which were purchased at the time at approximately the market rate of interest. Average yield on these securities is relatively low because much of the retirement fund's holdings consist of old, multiyear bonds which were issued at interest rates far below current rates. It should be pointed out, however, that the relatively low yield of the fund's holdings has no effect upon the ability of the system to pay the current level of benefits.

In 1969, a law was enacted which allowed the general revenues of the Treasury to be tapped in order to stabilize the retirement fund. In general, the law required any future benefits not backed up by trust fund assets to be endowed with interest payments to the fund as if those missing assets were actually present in the fund. This interest payment of the "unfunded liability" assured that income would be entering the trust fund sufficient to cover all benefits without further appropriations, and would continue to do so indefinitely.

This continuing and increasing subsidy insures the financial soundness of the retirement fund and does not depend upon the interest earned on the securities actually present. Thus, under the current system, because of the internal nature of the financing, it is reasonable for the government to maintain ownership of any assets actually present in the fund. In addition, because the current plan is a defined benefit plan subsidized by government payments, there is no advantage to the plan of private investment because benefit levels are not dependent on investment performance but upon the willingness of the federal government to continue to pay the benefit levels required by the present benefit formula.

However, the design of the new system makes private investment an attractive device for reducing government cost while providing employees with some return on economic performance. Since retirement income in the new system will in large part be dependent upon investment performance, simply requiring the system's contributions to be invested in special issues of the Treasury would be denying an opportunity to employees of improving their investment returns (and therefore their benefits) should the opportunity arise. Although interest earned on government securities is presently high, the long term experience has been that the guaranteed nature of government securities has meant a much lower

return than could be acquired through a more active and more speculative investment strategy.

Projections for adequate retirement income under the new plan are based on the assumption of a 2 percent rate of return (real rate) after inflation. Historically, the real rate of return on all private investments taken as a whole has been between 2 and 3 percent. Hence, assuming a 2 percent rate of return is a very reasonable expectation, given the size and diversity of federal retirement asset investment in the private sector under the new plan. Mandating investments in historically low yielding government securities would undermine the system and fail to provide the expected benefit.

This is not to say that investments in government securities will be prohibited. The Pension Board (the body which oversees investments in the new plan) will be given wide latitude in investments. Investment decisions will be subjected to the same "prudent man" and conflict of interest rules under ERISA, but the Board will have the opportunity to invest in a variety of income producing assets including high yielding government securities.

A well-rounded investment portfolio consisting of private and public instruments can provide reasonably secure and growing assets. A retirement fund accumulates contributions and investment earnings for 30–40 years and then continues to earn interest as the principle declines during the 15–20 years of retirement. Long term trends of the economy are more important to the experience of the fund and its participants than are short term fluctuations.

Normally, investors seek a strong mix of long term investments to assure stable growth in assets. In the past couple of years, however, pension investors have invested in shorter term securities to gain substantial rates of return. Occasionally poor growth periods could delay individual retirement decisions. On the other hand, strong economic performance balances out the poor times and could accelerate retirement decisions. In general, however, an earnings based plan will not interfere with rational retirement planning.

The legislation gives the Pension Board wide latitude in providing alternative forms of annuities. Comparable pension plans offer (1) a fixed annuity which in real terms declines in value over time; (2) an indexed annuity which begins payments at a lower rate and then increases them in monetary terms over time in order to hedge against inflation; (3) a variable or participating annuity which reflects changes in market conditions. Under our plan, when an individual retired, he could choose a form of an annuity that would be fully protected from market fluctuations, or one which provides both the advantages and disadvantages of greater risk.

Basically, when an individual decides to begin receiving his annuity, he is selling his account to the retirement fund for an income stream over the remainder of his life. If the economy does better than projected, the individual with a fixed growth annuity in a sense loses while the one with a risk annuity gains; if the economy does worse, the circumstances are reversed. However, unless an annuitant specifically chooses a variable annuity, market conditions will not substantially affect retirement income.

The general rule for the Pension Board is that investments should balance risks and returns so that account growth will be consistent with the need for dependable retirement planning. It is expected that investments will flow to a variety of stocks, bonds, money market instruments, real estate, and other income producing sources. Obviously, since the fund is for retirement, the vast majority of investments will be conservative. However, employees will have annual choices to direct their monies into general categories of investments. This will allow them greater opportunity to realize their own retirement objectives.

PROJECTED BENEFIT LEVELS

The system is designed to provide a greater retirement benefit than the current system for an individual retiring at age 65 after working a full 40-year career in government. The system does not require an employee to work that long to receive a benefit; in fact, employees at any age could leave federal employment after five years service and draw an annuity immediately. Of course, to retire on a liveable income would require far more service than five years, but as a practical matter, retirement at age 55 with 30 years of service would still be possible, although full benefits would not be received until age 62 when the social security payments began.

Another point worth mentioning here is the change in tax status of retirement benefits under our proposal. CSRS benefits are fully taxable as deferred compensation after an amount equal to the employee's total contributions to the system has been repaid in the form of an annuity, a period usually about 14 to 16 months. Treating CSRS benefits as taxable income is consistent with the treatment of private pensions, but not with the treatment of social security, which is not taxable under any circumstances.

Social security is considered a benefit for loss of earnings power due to old age, not as a pension benefit earned with each year of service. Regardless of the extent to which it might be argued that such distinctions are unfair or outdated, it remains unlikely that this differing tax treatment will be changed. Under the new system, a substantial part of each total retirement benefit would be paid from the social security program, thereby assuring federal retirees of the same advantageous tax treatment now afforded virtually all other employees.

Under the current system, once an employee's contributions are exhausted, his benefits are taxed. An employee who retires at age 65 with 40 years of service receives, depending upon his salary level, between 102 and 129 percent of his net preretirement earnings. That percent replacement decreases to 85–89 percent after approximately three years. Thus, replacement of an employee's after tax or net preretirement earnings decreases dramatically after the third year before leveling off and remaining constant for the rest of his life.

Under the new system, the same individual who chooses an indexed annuity is projected to receive 110–125 percent of his net preretirement earnings for the remainder of his life. An individual who instead chooses a fixed annuity will receive 129–145 percent of

his net preretirement earnings initially which gradually decreases to 94–128 percent after 15 years. Thus, even those who choose fixed annuities are in better shape than beneficiaries under the current system.

An individual who works until age 55 with 30 years of service under the current system receives 74–92 percent of his net salary which after 3 years decreases to 64–70 percent for the remainder of his life. Under the new system, the same individual would receive 32–50 percent of net salary at age 55, but the percent replacement would climb to 67–82 percent at age 62 when social security benefits began and would remain there for the rest of this life. While the aim of the system is to fully compensate those who work full careers in government, those who plan to retire early at age 55 will still be well protected in their later years.

Recognizing that many individuals familiar with this entire issue would want to be certain that we had projected benefit levels on some reasonable basis, we have sought to verify the study done by the Congressional Research Service (CRS) from which these figures were drawn. Projections of future benefit levels are highly dependent upon economic assumptions, and while the CRS study used a commonly accepted best-estimate set, we believed it advisable to select three other widely respected sets of long term assumptions, those of Chase Manhattan Bank, Data Resources, Inc., and the Wharton School of Finance.

We compared projected benefits for a worker retiring at age 65 with 40 years of service. Instead of using the net or after tax salary replacement rate, we used gross or before tax replacement rates. The gross replacement rates for the current system are 70.7 percent of final salary for all pay levels. Under DRI's assumptions, the same individual would receive an indexed annuity of 127–148 percent of salary for the rest of his life; a non-indexed annuity would initially yield 162–182 percent of preretirement salary, gradually decreasing to 103–127 percent fifteen years later.

Under Chase's assumptions, the individual would receive an indexed annuity of 126–144 percent of his salary for the rest of his life. If he chose a fixed annuity, he would initially receive 163–182 percent of salary, again gradually decreasing until it fell to 99–120 percent fifteen years later. Finally, under Wharton's assumptions, he would receive an indexed annuity of 140–160 percent of his salary for the rest of his life. If he chose a fixed annuity, initially he would receive 193–204 percent, gradually decreasing to 107–128 percent after fifteen years.

The economic assumptions used to project retirement income under this legislation are relatively conservative. Three alternative assumptions reveal higher retirement income. No doubt, more pessimistic figures could have been used to show retirement rates that were not as good as those projected. However, we thought it more reasonable to analyze the assumptions of reputable forecasters than to pull figures out of the air.

PROTECTION OF BENEFITS: EMPLOYEE CONTROL AND OWNERSHIP

The primary difference between the current plan and the new one is the question of ownership. In other words, to what is an em-

ployee entitled. We argued in the Defined Contribution section that unlike the current system in which an employee's benefit is dependent upon Congress' commitment to maintain the expected benefit, the new system provides the vested employee with a property right in the contributed monies and their earnings. Because vested employees would own these contributions, they could be granted the freedom to invest in instruments of their choice through representatives on the Board. Undoubtedly, some retirement assets would always remain invested in government securities. However, a quick analysis of large investors shows that an exclusive portfolio of government investments is highly unlikely.

Any private investment would enhance the contractural nature of the pension system. Although we argue that a property right devolves from the nature of a defined contribution plan, even if the money is invested solely in government securities, distributing employee monies through various private firms and into the economy strengthens the contractural and property concepts. The government would no longer be guaranteeing a benefit: not only would that be strong grounds for considering the employee's account sacrosanct, but any private investment would assure that accumulated contributions plus investment earnings could not even be reached by government action. Furthermore, because of varying portfolio mixes resulting from employee investment options, it would be virtually impossible to distinguish any government investment within each separate employee account.

CAPITAL FORMATION

I. Private investment: Key to growth

The formation of new capital is considered critical to economic growth. Currently, one of the most significant sources of this much needed capital comes from pension funds. The nation's largest 1,000 funds hold over $500 billion worth of assets. During this period of tight money and high interest rates, this source of financing is indispensable to some industries. There is evidence, for instance, that pension funds have kept the real estate industry afloat during the industry's severe recessionary periods.

The Civil Service Pension Fund would constitute a large pool of new capital. As mentioned previously, monies in the current retirement fund are simply held in government securities. The new fund would also contain substantial amounts of funds, but these funds would have the potential of vastly increasing capital available for revitalizing old industries, for beginning new businesses, and for all other purposes to which otherwise idle investment potential could be usefully put. The principle of investments is predicated upon rewards for the investor and the borrower. The investor increases his net worth while the borrower has a ready source of funds for business expansion. Under our plan, there would be available a greater pool of money to plan and build for the future.

II. Market absorption of new funds

The current fund holds approximately $80 billion worth of assets. If all of its benefit obligations were backed up by real assets, as the

new system will be, the fund's size would be in the hundreds of billions of dollars. Whenever private investments of this magnitude are contemplated, concerns arise as to whether markets could absorb such amounts without serious consequences for the economy.

Our legislation is designed to gradually wean the pension system away from government securities and into private holdings. For the new system's first five years, only employee contributions to the thrift plan would be permitted outside of the government. During the next five years, government contributions to the thrift plan would begin to be invested privately. Thereafter, each year an additional 10 percent of the new contributions toward the main pension would be available to the entire variety of investments. Thus, not until the twentieth year would 100 percent of the fund's new contributions be invested in securities outside of the government. Therefore, fears of flooding the markets with huge doses of money are unfounded.

During this transition period, much of the money is obviously held in government securities. To be equitable to participants during this time, money required to be invested in government securities would be guaranteed at a 2 percent real rate of return. With this guarantee, participants are assured that they will receive all the growth in their retirement accounts and thus benefit values will be accumulating at at least the value as the projections upon which the legislation is based.

III. Unfounded fears that the fund will control the market

Another concern we have heard raised is the possibility that the pension fund would eventually control the market. As previously discussed, private and public pension funds now hold over $500 billion of assets. While the Civil Service Pension Fund would contain significant sums of monies, as a proportion of the total investments in the economy the amount would be small, particularly by the time the transition period ends. In addition, the Pension Board would not have the authority to make direct investment decisions.

The Board's Executive Director would be required to contract with various private investment firms who would diversify the investments throughout the economy. Many large pension funds already act in a similar fashion. Trustees of these funds contract with various money managers, who then invest in a wide variety of investment opportunities. Thus, the Civil Service Pension Fund could not be in a position to control the market any more than other large pension funds.

IV. Protection from political pressure on the use of the fund

Fears of political pressure to direct investments in various ways are also unfounded. The Board members, composed of the Secretaries of Treasury, Labor, and Commerce, the Chairman of the Federal Reserve Board, and six members appointed by the President from recommendations of federal labor and manager organizations, would not have direct authority over investments. Such authority would be vested in the Executive Director. This individual would be appointed by the President for a seven-year term with the advice and consent of the Senate. He would be a professional money man-

ager from the private sector. He, as well as the Board members, would be under the restrictions applied to private pension investors that require the "prudent man" rule in the practice of investing.

V. No increase in Government borrowing

Arguments have been made that investing government contributions in the private sector would require the government to first borrow the money from the private sector and then put it back in at a net loss. It is then argued that the government investment in the private sector would create upward pressure on interest rates because of increased government borrowing. No mention is made of the effect upon interest rates of having substantial amounts of new capital available for private investment. Nor is it pointed out that gradual increases in government outlays for investment will be more than offset by the gradual decreases in government outlays for benefit payments as the transition to the new retirement plan gets underway.

The current system actually contributes to the deficit and thus to government borrowing because every time benefits are paid, government outlays ensue. Thus, the difference between employee contributions and benefit payments during the year contributes to that year's deficit. By gradually investing the contributions in the private sector, and by assuring that benefit payments will be drawn from those contributions and not from annual general fund subsidies, over the long-run our plan gradually reduces the effect on the federal budget of federal employee retirement benefits.

The major difference in the impact on the federal budget of the two systems is the point at which outlays will actually occur. In the current system, outlays are delayed until the benefits are paid and then are of the amount of the benefits. In the new system, outlays occur when the employee's account begins to be invested five years after beginning employment. Government borrowing is not increased by the new system; government payments in the form of contributions are made earlier and earn income outside the government, thereby reducing government costs. Thus, government costs simply occur at a different point in the system's existence and at a savings to the taxpayer.

The real question is what happens to the money when it leaves the government's hands. In the current system, it goes directly to an annuitant, in the form of a benefit payment, who then spends most of it to meet his needs. In the new system, it goes through the hands of investors into predominately long term investments. In a sense, one could say the current system is economically biased towards consumption, whereas the new system bolsters investment. As was discussed earlier, the increased formation of new capital is an important ingredient in any program to return the economy to prosperity.

NEW OPPORTUNITIES

Private investment opens the door to a multitude of opportunities for plan participants and for the economy. The much publicized IRAs with their promises of future wealth pale in comparison with the real returns and opportunities afforded through private

investment of the new Civil Service Pension Fund. Private investment is synonymous with economic wealth for the individual and for the society. For the first time, federal workers will have available to them this same wealth. In one sense, an investment-based retirement plan earning investment income in the private sector shifts some risk to employees. However, in light of almost certain changes to the current system, the proposed system is far more protective of employee benefits and certainly more flexible than the current one.

Protections and Provisions for the Current Worker

As mentioned many times in prior sections, the new Civil Service Pension Reform bill mandatorily applies to only new federal employees. Yet, often voiced and reasonable concerns are what will happen to the current system as the number of beneficiaries dwindle; what assurances do the current workers have that they will receive what they were promised; and, finally, what provisions apply to current workers who elect to join the new system?

PROTECTIONS FOR THE CURRENT WORKER

The current system has come under increasing attack in recent years due to its cost, its unfunded liability and its benefits superior to those found in the private sector. Benefits such as the one percent kicker, and "look-back" formula, the twice-a-year cost-of-living adjustment and the full cost-of-living adjustment applied to retirement benefits received at any age have been either repealed or changed drastically. Yet, the attacks persist. Note the recent CBS "Sixty Minutes" presentation of the retirement system.

Our new system is designed to protect and maintain the commitments made to the current work force. We feel the only way to prevent further changes is to establish a fully funded, less costly system for new workers modeled after a good, typical private sector plan. By doing so, however, it is with the recognition that the current system becomes a closed system to which fewer employees will contribute and, hence, income to it will dwindle. Many may see that as a potential threat to the viability of the current system. It is not.

Income to the current system comes from a variety of sources. In Fiscal Year 1980, income to the trust fund was as follows:

CSR TRUST FUND FINANCING, BY SOURCE: FISCAL YEAR 1980

[Dollars in billions]

Source	Contributed	Percent of total funding
Employee contributions	$3.6	14.9
Employing agency contributions	2.8	11.6
Off-Budget agency contributions	1.5	6.2
Earned interest and other income	5.0	20.7
Appropriations from the general fund of the U.S. Treasury	11.2	46.5
Total trust fund income	24.2	100.0

Source: U.S. Budget appendix for fiscal year 1982, P. I-V118.

Since outlays in fiscal year 1980 were approximately $14 billion, it appears the system is well funded. While the system is clearly solvent, it is not fully funded. The system was intended to assure that an employee's actual contributions matched by his agency's would pay for the benefit he would later receive. In reality, today's contributions pay for today's retirees. If the current system were closed and the funding were not changed, the system would clearly run out of money and be unable to pay the benefits for the current work force.

Since our new proposal closes the current system, i.e., new employees will instead be under the new system, a mechanism to fully fund the current system must be adopted. Our proposal remedies this in two ways.

One, it requires the agencies to pay the full retirement costs of their employees. Best projections reveal that the retirement cost of a current worker is 36.8 percent of his salary. Since an employee contributes 7 percent of his salary toward his retirement, to fully fund a worker's account, our bill requires his employing agency to contribute the remaining 29.8 percent.

Two, the unfunded liabilty of the retirement system which is approximately $500 billion is amortized over a forty-year period. The combination of these two provisions assures that adequate money will be in the fund as every worker retires.

The sole reason the solvency of the fund is jeopardized by the cessation of new contributions is because the system is not currently fully funded. By assuring that full contributions are made annually for a worker's benefit plus the forty-year amortization schedule of the unfunded liability, there will be no need for new workers' contributions to keep the system operating. There will be sufficient sums in the trust fund to pay the last retiree's final dollar.

It would appear that increasing agency contributions to the retirement system plus paying off the unfunded liability would have an adverse impact on the federal budget. In fact, these changes have no impact on the budget. Agency accounts and the retirement trust fund are part of the same federal budget. A debit to an agency account in the form of increased contributions is an asset to the retirement fund in the form of additional holdings. The overall budget is not affected; it is simply an accounting transfer within the budget.

The same is true for the amortization of the unfunded liability. Paying off the unfunded liability will require that the current payments from the general revenues of the Treasury to the retirement fund be increased. Again, however, there is no budgetary effect. Both accounts are within the federal budget.

The only action in the retirement system that affects the budget is the payment of benefits to retirees and contributions to the fund from employees. All other transactions have no budgetary effect. The money is simply transferred from the general fund to the retirement fund. Fully funding the current system will assure that the level of benefits promised to the current work force will be paid.

As mentioned previously, our new proposal is predicated on the fact that the current system will remain unchanged for those who elect to remain in it. One of the purposes written into the new legislation is to guarantee the right of all current workers to enjoy

the current level of benefits of the system. In other words, as best we can, Congress is making a commitment not to change the level of benefits under the current system after the enactment of the new legislation.

In addition, current workers will receive an annual statement valuating their current level of benefits. Instead of knowing the amount of their own contributions, workers will be apprised of the current value of their benefits. This is designed to legally strengthen their ties to a certain benefit. The courts have consistently held that publicly provided retirement benefits are a statutory entitlement which Congress or the legislature can change at any time, a Congressional prerogative exercised with increasing frequency during these years of severe budgetary restraint. Furthermore, the courts have held that the employees under these systems do not have any contractural rights to the benefits. In our plan, however, the annual provision of a valuated benefit plus a statement guaranteeing an employee's rights to the current level of benefits strengthens the legal ties to that benefit. While one Congress cannot bind another, establishing these greater rights to existing benefits would make them more protected than they are now.

OPTIONS TO CURRENT WORKERS WHO ELECT TO JOIN THE NEW SYSTEM

While the new system is designed for new workers, there are options allowing current workers to join. The new system contains a number of advantages over the current system, i.e., increased portability, greater flexibility, better survivor and disability protection, and better benefits for full career employees.

Most employees, when they join government, do not plan to make it a career. However, the current retirement system inhibits workers who have served for a number of years from leaving. If they do, they lose virtually all of their benefits. Under this new plan, an employee is not penalized for leaving government early to pursue another career. As was discussed in other sections, an individual can leave government after five years and take with him all the government contributions, his own contributions, and any accumulated earnings on those contributions. He could also draw an immediate annuity, or defer it to a later date and allow it to continue to draw earnings. This will be a great attraction for current workers.

In recent years, pay caps and benefit cuts have made government work unappealing and at times discouraging. Government workers, though, often cannot afford to switch jobs and lose their retirement rights. In addition, and in some cases, more important, they should not be unprotected for disability and survivor benefits when they do separate from their government jobs. The new plan protects workers from these situations. The more lenient vesting requirement in the new plan described above provides alternatives to workers who may wish to leave government early. Social security coverage ensures continued disability and survivor protection between jobs. We feel these benefits alone will attract a large number of current workers to the new system. In addition, with the recent imposition of the Medicare tax on the current work force, current workers will find joining the new system to be finan-

cially attractive. A current worker could have greater disposable income by participating in the new system since the only mandatory contribution is the social security tax which is 6.7 percent of the first $35,700. This compares to the 7 percent contribution under the current retirement system, plus the 1.3 percent Medicare tax. Alternatively, the additional income could be used to participate in the thrift plan.

A current worker who joins the new system must participate in it for five years (except for survivor benefits, which are earned generally after 18 months) to enjoy all its benefits. As an incentive to join the new system, two buy-out options of his current retirement credits are provided. In the first option, the government would match dollar for dollar the employee's total contributions to the current system, and apply a factor of five percent to represent interest compounded for all of his years of employment. This sum would be transferred to the new system.

In the second option, the present value of accumulated future benefits is computed, using an inflation factor of six percent. As in the first option, this new sum would be transferred to the new system to the employee's account. The first option is more beneficial to those with less than about thirteen years of service; the second option is more beneficial to workers with service greater than thirteen years. Here's an example:

Assume an employee entered government at age 25 with a starting salary of $10,000 and received annual pay increases of six percent. At age 30 the first option would yield him $9,100; the second option, $4,400. At age 45 the first option would yield him $81,400; the second option, $125,000. Remember that these sums are in the name of the employee and are available to him if he decides to leave government after participating in the new system at least five years.

Moreover, protections are afforded to those current workers who join the new system but for some reason fail to meet the vesting requirement of five years. In those cases, the current workers may either withdraw their own contributions or their years of service will be recredited to the current retirement system.

For example, assume an employee has worked fifteen years under the current system. He then joins the new system, and he chooses one of the buy-out options. He works for three more years under the new system and then resigns. He may either withdraw the contributions he originally made under the current system plus any contributions to the new thrift plan, or he may have his full eighteen years recredited to the current system. This arrangement protects a current worker who joins the new system from unforeseen circumstances which could disrupt his working career and cause him to lose everything.

While the new system is specifically designed for a new work force, the aforementioned features make it very attractive for current workers to join. The flexibility and portability of the benefits in the new system would certainly lure those who have not yet decided that they want to make government work a career. The special buy-out options provide a great incentive to a current worker who desires to quickly build a substantial retirement fund for his later years. Many current workers will find this new system very

appealing. Those who do not will likely be protected from further changes.

Income Protection in the Event of Illness or Injury

Up until now, we have concentrated strictly on the retirement part of our proposal to restructure the Civil Service Retirement System. Another major improvement is in the protection a worker would have upon becoming temporarily disabled, totally and permanently disabled, or sick for an extended period of time.

Contrary to popular opinion, the current sick leave and non-work related disabling systems fail to adequately protect workers from long illnesses or disabling injuries. (Work related injuries will continue to be covered under the Federal Employee Compensation Act and are not affected by any changes in our proposal.) Long illnesses or injuries requiring long recuperation periods can be financially devastating.

Federal sickness and disability protections pale in comparison to typical private sector coverage. Good private sector coverage usually includes a combination of sick leave, accident and sickness insurance, and long term disability protection. While the federal government now offers fairly generous sick leave benefits, long term disability protection is inadequate, and protection is virtually nonexistent for individuals who exhaust their sick leave because of a recurrent illness or the need to recuperate from sickness or injury.

Currently, each full time employee receives 13 days of sick leave a year, or four hours every two weeks. Unused sick leave may be accumulated for future use. These sick leave days are designed to cover short term absences with accumulated unused leave intended to provide protection against longer term absences. This arrangement, for the most part, is the only financial protection the employee has for all illnesses or injuries, short and long.

The only other protection available to federal workers for long illnesses or disabling injuries is that offered by the disability retirement program. That protection is limited, however.

1. An employee is not vested for disabilitiy retirement until he has served for five years or more in the federal government.
2. Until the employee serves in the government for 22 years, his maximum benefit will be 40 percent of his high three average salary.
3. Disability retirement is the only option for an employee who exhausts his accumulated sick leave even if the illness or disabling injury is of a temporary nature. Once an employee chooses to retire on disability, he is no longer guaranteed the right to return to his old job upon recovery.

Our proposal revamps the sick leave and disability systems for those who come under the new retirement plan, namely all new federal workers and those current workers who elect to join the new system. Current workers who do join will be required to exhaust their accumulated sick leave before using the benefits under the new system. Current workers who prefer to stay in the current retirement system would not be affected by any of the proposed changes to the sick leave and disability systems. Our proposal is patterned after good private sector systems.

SHORT TERM PROTECTION

Our proposal provides for seven days of non-accumulating sick leave. These days are designed to cover employees' medical appointments and minor illnesses. Over the years, average usage of sick leave in the federal work force has approximated eight days a year. However, that usage included time for both long and short term absences. Since long term absences will be covered by other arrangements discussed below, the annual provision of seven days of sick leave will be fully adequate for short term protection of federal workers.

INTERMEDIATE PROTECTION

The absence of adequate protection for long, but not necessarily permanent, absences is the current system's greatest failing. This is particularly true for employees early in their careers. The sole way in which employees gain financial protection from long illnesses and injuries is to refrain from using sick leave. If employees use an average of eight days of sick leave per year, an average employee would need 25 years of service to be protected from a six-month absence, certainly a not unheard of length of time for recuperation from a serious illness or injury. Even an employee who uses absolutely no sick leave would require ten years to accumulate such time.

Our proposal fully protects an individual in such a situation from the first day on the job. The provisions covering sickness and accident insurance protect workers up to six months for each serious illness or accident. Coverage begins at 100 percent of gross pay for a few weeks, declining to 80 percent and then to 60 percent over a 26-week period, after which other longer term disability protection begins. Employees with more years of service have more weeks of protection at 100 percent of pay, then 80 percent, etc.

For example, an employee with two years of service has two weeks of coverage at 100 percent, six weeks at 80 percent and 18 weeks at 60 percent of pay. Someone with five years of service or more has five weeks of coverage at 100 percent, nine weeks at 80 percent and 12 weeks at 60 percent of pay.

This schedule renews itself with each new occurrence of an illness or injury. Each illness or injury will have a generally prescribed period of expected recovery established by the Pension Board. Say a specific kind of back surgery may warrant 16 weeks of recovery. If an employee of ten years has back surgery, he will receive seven days of sick leave, plus five more weeks all at 100 percent of pay, nine weeks at 80 percent and the remaining week at 60 percent. If that same employee returns to work and receives a new injury with a scheduled four-week recovery period, those four weeks are again insured at 100 percent of his pay.

LONG TERM DISABILITY PROTECTION

If a disabling sickness or injury causes an employee to exhaust coverage under the sickness and accident insurance provisions, he will be entitled to a short term disability benefit. This benefit extends up to 18 months and pays 60 percent of an employee's pay

(offset by any social security disability benefits received). Comparable protection under the current system is provided under the disability retirement provisions which generally only pay 40 percent of the average of the high three years of pay. Moreover, entitlement to disability protection available under the current system does not vest until an employee works for five years in the government. Vesting in the new system occurs after the first year of employment. In addition, because social security protection is earned, and therefore carried to virtually all employment in society, employees leaving their federal jobs would not undergo periods without any disability protection as they enter new employment.

Under our proposal, disability beyond two years will be covered by long term disability provisions. To qualify for long term disability, one must either be deemed disabled under the Social Security Act, in which case the employee will receive 60 percent of his pay until death or restoration, or be unable to work in any federal job in his commuting area, in which case he will receive 40 percent of pay. If the employee is capable of working in any federal job in his area, he will be guaranteed the next available position for which he is qualified. He will receive the greater of the pay of his new position or 60 percent of the pay of his original position and will be entitled to pay retention provisions in current law. This would assure a gradual reduction of pay in the case where the individual was disabled from a high paying position and was placed in a lower paying job. This fairly complex arrangement is to be compared with the current disability system's benefit of approximately 40 percent of pay, with no reemployment guarantee.

Taken together, our proposed redesign of the sick leave and disability systems provides for a more extensive coverage for sicknesses and injuries. The five-year gap or vesting period in the current law is closed. Protection for long but temporary disability is far greater in the new plan. Even long term disability coverage is more generous in the new system. Finally, an employee who leaves government before retirement will no longer face periods of no disability protection due to the portable disability coverage provided for in the social security benefit.

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II. SECTIONAL ANALYSIS

Title I—Civil Service Pension System

SUBCHAPTER I—DEFINITIONS

§ 8401. This section establishes various definitions for the new pension system.

SUBCHAPTER II—CIVIL SERVICE PENSION SYSTEM

§ 8411. Civil service pension system; participation

The bill establishes a new civil service pension system. The new system consists of a defined contribution plan and a thrift or savings plan. This section provides that all employees who were hired or rehired into federal service after the enactment date of this bill will be covered by these new pension provisions. Employees under the current Civil Service Retirement System have the option of choosing coverage under the new system or continuing to participate in the current Civil Service Retirement System.

§ 8412. Defined contribution plan

All employees in the new system are mandatorily covered under the provisions of the defined contribution plan. Employees do not contribute, however, to the contribution plan. Each agency must contribute into the account of each covered employee an amount equal to 9 percent of the first $20,000 of annual basic pay plus 16 percent for every dollar of basic pay over $20,000. The $20,000 figure will be indexed to rise at a rate equal to the percentage of each year's pay adjustment under the General Schedule. Also, the Secretaries of the Military Departments will have to contribute to the fund at this rate for the years a participant served as a member of the uniformed services. This requirement generally does not apply to those who are entitled to military retired pay.

§ 8413. Thrift savings plan

All employees in the new system may voluntarily participate in the thrift or savings plan. If they choose, they may contribute as much as 16 percent of their annual salary. The employing agency must match that amount dollar for dollar up to a 3 percent of salary maximum. All government contributions to both the defined contribution and thrift plans are paid by the agency out of appropriated salary and expense funds.

§ 8414. Annuity: Vesting; payment method; amount

Employees participating in the new system are vested after five full years of federal service under the system. After being vested, the employee has the right upon separation from federal service to

elect a monthly annuity based on all funds in his or her individual account including all returns on investments, past and future. The Board will prescribe the methods of payment of annuities. The amount of the annuity will be based actuarily on the employee's age at the time the employee separates or at a later date elected by the employee. A reduced annuity will be available to provide survivor benefits for the employee's spouse in the amount of 55 percent of the monthly annuity payable on the day before the death of the annuitant. Increasing annuities will also be available to hedge against inflation.

§ 8415. Deferred retirement; withdrawal in lieu of annuity

A vested employee who separates from federal service may elect in writing to take an annuity at a date after separation. The annuity amount will be based actuarily on the individual's age at the date the individual is to begin receiving the annuity. The individual may also elect to receive all the money in his or her account in one lump sum payment.

§ 8416. Death benefits

If a participant dies before receiving an annuity, a death benefit in the term of a monthly annuity or lump sum payment based on the balance of the deceased employee's account will be paid to his or her survivor(s).

§ 8417. Civil service pension fund

A new Civil Service Pension Fund is created consisting of all government contributions to the defined contribution plan, all employee and government contributions to the thrift plan, and all returns minus any losses on investments of these contributions. The sums in the fund are to be used only for investment, the payment of benefits and the payment of expenses incurred in the administration of the fund. The sums in the fund are not subject to execution, levy, attachment, garnishment or other legal process except for certain obligations to provide child support or alimony.

§ 8418. Investment of the fund

The funds will be invested initially totally in government securities with the funds slowly being infused into private sector investments over several years. Investments of the contributions to the defined contribution and thrift plans will be moved to the private sector in varying ways. Investments mandated to be made in government securities are guaranteed a 2 percent real rate of return.

For the first ten years of the new system, all contributions to the defined contribution plan must be invested only in government securities. For the next ten years thereafter an additional 10 percent per year of all new contributions will be transferred to private investments until the 21st year of the plan when all the then new contributions will be invested through the private sector.

In the first year of each employee's participation in the thrift plan, all contributions, government and employee, will be invested only in government securities. The second through the fifth year, the employee contributions will be invested through the private sector and the government contribution will remain in government

securities. From the sixth year on, all new contributions will be invested through the private sector.

Once the twenty-year cycle is completed, the government contributions for the first five years of each new participant will be invested in government securities. Every year thereafter all new contributions for that participant will be invested through the private sector. Earnings on these investments from the defined contribution and thrift plans will be credited to the participating employee's account on a pro rata share basis. Each employee will determine what type of investment (private) and how much of their fund to each investment shall be made.

§ 8419. Administrative provisions

Each participating employee will have an individual record maintained showing how much money has been contributed by the employee and the government to both the defined contribution and thrift plans, how much of each is maintained in both public and private investments, the accumulated earnings from such investments, and disbursements from the individual's account upon separation or death. Each year the employee will be given a copy of this record of his or her account.

§ 8420. Transition provisions

Employees under the current retirement system are given the opportunity to join the new pension system. Such employees must elect in writing to join the new system. Employees electing to "buy into" the new system will have their credit in the old system satisfied by transferring money into an account in the new system.

The amount of money transferred to the new system will be the greater of the following two formulas. The first formula is equal to the employee's unrefunded contributions in the current system matched by an equivalent amount of government contributions. Each year's worth of contributions will receive five percent interest, compounded annually up to the time of transfer to the new system.

The second formula is equal to the present value of the accumulated benefits the employee has earned as a result of the employee and government contributions. This amount, actuarily determined, will assume an average annual increase in cost of living of six percent. The greater amount of these two formulas will be transferred to an account in the new system for the electing employees.

An electing (transferring) employee must remain in federal service for five years after transferring to receive the full benefit of these amounts.

If an employee converts to the new system but separates before vesting in the new system, that employee may revert to coverage under the old system or be refunded his contributions to both systems.

§ 8421. Payment of benefits; commencement, termination and waiver of annuity

The payment of an annuity will be on a monthly schedule. Payment will begin upon separation or date after separation elected by

the employee. The annuity terminates upon death of the annuitant or survivor.

§ 8422. Audit

The Comptroller General shall, not less frequently than every two years, conduct such audits of the financial condition as he shall deem necessary.

SUBCHAPTER III—ILLNESS AND ACCIDENT INSURANCE BENEFITS: DISABILITY COMPENSATION

§ 8451. Definitions

This section gives a few basic definitions for the new Illness and Accident Insurance Program which will replace the existing sick leave system for participants. The most important one is the basic definition of "disabled." A participant is disabled if he is unable, because of disease or injury, to render useful and efficient service in the participant's position, and is not qualified for reassignment, under procedures to be established by OPM, to a vacant position.

§ 8452. Illness and accident insurance benefits

A new benefit structure has been established to pay eligible employees for periods of incapacitation to perform the duties of their position. Only those employees participating in the new pension system are covered. The illness and accident insurance portion of the overall program covers incapacitation for periods of 26 weeks or less. In such a situation where the employee is temporarily unable to perform the duties of his or her position, the employee receives graduated percentages of his or her basic pay, decreasing from 100 percent to 60 percent, for specified numbers of weeks, up to a maximum of 26, depending upon length of service. Employees must meet a waiting period of five work days to qualify for this benefits terminates upon restoration of capacity of employee, expi- without pay to fulfill this waiting period. Entitlement to these benefits terminate upon restoration of capacity of employee, expiration of applicable recovery period provided in schedule of impairments, expiration of prognosis period provided by authorized physician, or expiration of the 26-week period. These benefits are paid from the agency's salary and expense appropriation account.

§ 8453. Short term disability compensation

If an employee is determined to be disabled for federal service based on a physical examination which will be required by OPM, the employee is entitled to receive a monthly short term disability payment of 60 percent of basic pay for the period after accident and sickness insurance terminates but no longer than 24 months from date of disability. If the employee is also receiving social security disability benefits, that amount is subtracted from the short term disability benefit provided by this section.

§ 8454. Long term disability compensation

An employee who, at the end of the 18 months of short term disability is still determined to be disabled based upon an appropriate physical examination, and who cannot be placed by OPM in an-

other position for which physically qualified, must be separated and is entitled to a long term disability payment. This payment is 40 percent of the monthly rate of basic pay if not considered disabled by social security or 60 percent of his monthly salary minus an amount equal to his social security monthly disability benefit if he meets the social security disability test. If the social security payment is equal to 60 percent of the employee's salary, he will receive, as a minimum, $50 a month in addition to his social security. In either instance, the long term disability payment is reduced by the amount of annuity which the employee is entitled to receive from the Pension Fund.

§ 8455. General provisions

Any participant receiving illness and injury benefits, short term disability compensation, or long term disability compensation shall be examined by a physician under the direction of OPM or the Board, as appropriate, as the case may require. Any participant who fails to submit to the examination shall not be entitled to the benefits or compensation provided for. An employee who is deemed physically qualified for a federal position must be placed by OPM in any such vacant position in the employee's commuting area. The employee will receive the greater of his new salary or 60 percent of his original salary. Also, any participant who is offered placement to an appropriate position within a reasonable commuting area and who refuses placement is not entitled to such disability compensation.

SUBCHAPTER IV—CIVIL SERVICE PENSION BOARD

§ 8491. Establishment of Civil Service Pension Board

An independent agency referred to as the "Civil Service Pension Board" in the executive branch will oversee the new system. The Board will consist of 11 trustees: the Secretaries of Treasury, Commerce and Labor, the Chairman of the Federal Reserve Board, and six members appointed by the President. These six appointees will come from individuals recommended by management and employee organizations.

An additional Presidential appointee will be an Executive Director for the Board whose experience must include management of financial investments. The Director will be appointed for seven years.

The Board will meet at least four times a year and at the call of the Director to perform the functions of the Board.

§ 8492. Functions

The duties of the Board consist primarily of oversight, of the process for negotiating contracts with private investment firms and of the performance of those investments. The Board will establish policies for managing the fund. The Board will determine the types of investment categories and number of options for investment which will be offered to participating employees. Lastly, the Board will oversee the actions of the Executive Director. The Executive Director will be the chief operating officer of the Board and will preside at the meetings of the trustees.

§ 8493. Powers and administrative provisions

The Board may disapprove any investment action of the Executive Director by obtaining seven votes of the trustees against any such action. A similar seven votes can direct the Executive Director to take other actions, except with regard to investments, the Board considers necessary to carry out the provisions of the new system. The Board may prescribe rules to carry out the provisions of the new system. The Executive Director has the authority to staff and to pay the personnel of the agency. The Director's primary responsibility will be to negotiate contracts with private sector firms for investing the money of the pension fund. The Director will also provide the information and procedure for employees to make the necessary investment decisions called for by regulations.

The contracts for investing these funds will call for maximum return on the investments while using prudent financial investing criteria.

§ 8494. Fiduciary responsibilities

The members of the Board (trustees) and those individuals in a private business with whom the Board negotiates a contract for investment purposes must meet fiduciary responsibilities similar to those called for in ERISA. These requirements require prudent, sound investment of the funds which balance maximizing returns while minimizing risks.

TITLE II—MISCELLANEOUS AND CONFORMING AMENDMENTS

AMENDMENTS TO SECTION 5315 OF TITLE 5

SEC. 102. The Executive Director of the Civil Service Pension Board will be paid at the Executive Level II rate of pay.

AMENDMENTS TO SECTION 5363 OF TITLE 5

SEC. 201. The pay retention provisions of this section are amended to include a special pay retention provision for those individuals who take a lower graded position under the new disability provisions. The normal pay retention process would be followed except that a floor of 60 percent of the pay of the employee's higher graded position, held at the onset of disability, would be imposed.

AMENDMENTS TO SECTION 6307 OF TITLE 5

SEC. 202. Employees covered under the new pension system are also covered under new sick leave provisions. They earn seven days of sick leave a year immediately upon hiring and each anniversary date after that. Any days unused at the end of the anniversary year are lost and do not accumulate. This sick leave can be used under the same conditions as current sick leave is used.

AMENDMENTS TO CHAPTER 83 OF TITLE 5

SEC. 203. This section requires each agency to contribute to the current retirement fund the true cost of current employees' retirement benefits. These costs are based on dynamic assumptions. This

section also requires the Treasury to pay off the current unfunded liability amortized over 40 years. The purpose of this section is to fully fund the current retirement program.

Also, an individual covered by the current retirement provisions who separated from the federal service, kept his money in the retirement fund and is rehired under the new pension system will upon retirement have the old retirement benefit computed on the years of service and high three years pay in effect at the time of initial separation. Additionally, all employees under the current system will be given an annual statement of the value of the benefits in their retirement account.

SEC. 204. This provides for court ordered survivors' annuities, under chapter 83, making it comparable to the existing court ordered share of the normal annuity. It also provides that OPM will reduce a full annuity to provide the appropriate survivor annuity, unless notified to do otherwise.

ADDITIONS TO CHAPTER 83 OF TITLE 5

§ 8349. Annual statement

Employees choosing to remain under the existing Civil Service Retirement System will be provided with an annual statement of the present value of the future benefits payable to the employee. This present value will be determined actuarialy based on the creditable service and average pay of the employee on the last day of the fiscal year.

§ 8350. Applicability

Unless otherwise specified, amendments made to Chapter 83 (by this law or the new provisions of Chapter 84) are applicable only to those employees who are covered by the new pension system.

AMENDMENTS TO CHAPTER 89 OF TITLE 5

SEC. 205. The Office of Personnel Management is authorized to devise Medicare wraparound plans with the major carriers. That is necessitated by the coverage under Medicare of federal employees in the new retirement system.

CONFORMING PROVISIONS FOR OTHER RETIREMENT SYSTEMS

SEC. 206. Organizations whose employees are covered by the current retirement system and which are considered "off budget" will be required to pay the true dynamic cost of their employees' participation in the current system.

TITLE III—SOCIAL SECURITY AMENDMENTS

SOCIAL SECURITY COVERAGE FOR NEW FEDERAL EMPLOYEES

SEC. 301. Employees who are mandatorily or voluntarily covered by the provisions of the new pension system will begin paying the social security old age, survivors, disability and Medicare taxes as of January 1, 1984. Federal service on and after that date will be considered service creditable toward attaining social security coverage. Employees will have to meet the same quarters of coverage for

attaining eligibility as private sector employees; i.e., up to 40 quarters for retirement and 20 quarters for disability and survivors benefits.

No current federal annuitants are affected by the provisions of this section.

TITLE IV—AUTHORIZATION AND EFFECTIVE DATE

FIRST YEAR EXPENSES OF THE SYSTEM

SEC. 401. Startup costs for the system will be met by appropriated funds.

EFFECTIVE DATE

SEC. 402. January 1, 1984 is the effective date for Titles I and II.

III. REPLACEMENT RATES BY THE CONCRESSIONAL RESEARCH SERVICE, THE LIBRARY OF CONGRESS

SOCIAL SECURITY II–B ECONOMIC ASSUMPTIONS

The following tables compare an individual's retirement benefit under our legislation versus the current system. The tables reflect benefits at a variety of ages and salary levels. The non-bracketed numbers reflect the percentage of one's gross preretirement earnings of his final salary. In other words, the retirement benefit is described as a percentage of his final salary. For example, 72.3 means a retiree will receive 72.3 percent of his final salary as a retirement benefit. The bracketed numbers are a percentage of one's net preretirement earnings, or after tax earnings. This is significant because unlike civil service retirement benefits, social security benefits are not taxed. Thus (101.9), means the value of one's after tax retirement benefit versus his after tax salary.

Table I describes an individual who retires at age 65 with 40 years of service and who receives an indexed annuity of four percent. Inflation is also assumed to be four percent.

Table II describes the same person who receives a fixed or non-indexed annuity.

Table III describes someone retiring at age 55 with 30 years of service and who receives an indexed annuity. Note at age 62 the jump in benefits under our plan. This is due to the commencement of the social security payment.

Table IV describes the same person who receives a fixed annuity.

TABLE I

Percentage of Gross and Net Preretirement Earnings Replaced
by an Indexed Annuity For Employees Retiring
at Age 65 with 40 years of service
(net in parenthesis)
(indexing = 4 percent annually)

Selected general schedule	Current CSRS	Value of benefits without participating in thrift	Value of benefits from employer contributions only	Full value of benefits including employee contributions
Low 65	72.3	66.2	76.1	85.9
	(102.5)	(90.9)	(101.9)	(113.2)
...... 70	72.3	66.2	76.1	85.9
	(85.3)	(90.9)	(101.9)	(113.2)
...... 80	72.3	66.2	76.1	85.9
	(85.1)	(90.9)	(101.9)	(113.2)
Mid 65	72.3	58.0	67.2	76.3
	(127.9)	(89.9)	(100.7)	(110.5)
...... 70	72.3	58.0	67.2	76.3
	(89.5)	(89.9)	(100.7)	(110.5)
...... 80	72.3	58.0	67.2	76.3
	(89.5)	(89.9)	(100.7)	(110.5)
High 65	72.3	67.4	77.9	88.8
	(129.1)	(100.4)	(112.0)	(122.6)
..... 70	72.3	67.4	77.9	88.8
	(89.3)	(100.4)	(112.0)	(122.6)
..... 80	72.3	67.4	77.9	88.8
	(89.5)	(100.4)	(112.0)	(122.6)
Postal ... 65	72.3	71.3	82.4	93.5
	(105.8)	(98.7)	(111.7)	(124.1)
... 70	72.3	71.3	82.4	93.5
	(85.8)	(98.7)	(111.7)	(124.1)
... 80	72.3	71.3	82.4	93.5
	(89.5)	(98.7)	(111.7)	(124.1)

Note: Assumes thrift plan of 100 percent employer match of employee contribution to 3 percent of salary. All economic assumptions, and documentation of methodology and "selected general schedule" career histories are detailed in: U. S. Congress. Senate. Committee on Governmental Affairs. Restructuring the Civil Service Retirement System: Analysis of Options to Control Costs and Maintain Retirement Income Security. Committee Print, 97d Cong., 1st Sess. Washington, U.S. Govt. Print. Off., 1982.

Source: Congressional Research Service.

TABLE II

Percentage of Gross and Net Preretirement Earnings Replaced
by a Nonindexed Annuity For Employees Retiring
at Age 65 with 40 years of service
(net in parenthesis)

Selected general schedule	Current CSRS (indexed)	Value of benefits without participating in thrift	Value of benefits from employer contributions only	Full value of benefits including employee contributions
Low 65	72.3	76.5	89.7	103.0
	(102.5)	(102.4)	(117.5)	(132.0)
...... 70	72.3	69.4	80.3	91.2
	(85.3)	(94.5)	(106.9)	(119.1)
...... 80	72.3	58.8	66.1	73.5
	(85.1)	(82.3)	(90.8)	(99.1)
Mid 65	72.3	71.2	83.5	95.8
	(127.9)	(105.0)	(117.9)	(129.6)
...... 70	72.3	62.1	72.2	82.3
	(89.5)	(94.7)	(106.2)	(116.7)
...... 80	72.3	48.5	55.3	62.1
	(89.5)	(78.0)	(86.6)	(94.8)
High 65	72.3	83.5	98.2	112.9
	(129.1)	(117.8)	(131.4)	(145.0)
..... 70	72.3	72.1	84.2	96.2
	(89.3)	(106.0)	(118.4)	(129.6)
..... 80	72.3	55.0	63.2	71.3
	(89.5)	(86.4)	(96.1)	(105.1)
Postal ... 65	72.3	83.5	98.5	113.5
	(105.8)	(113.0)	(129.6)	(145.1)
... 70	72.3	75.1	87.4	99.7
	(85.8)	(103.2)	(117.4)	(130.8)
... 80	72.3	62.4	70.7	79.0
	(89.5)	(88.3)	(98.0)	(127.8)

Note: Assumes thrift plan of 100 percent employer match of employee contribution to 3 percent of salary. All economic assumptions, and documentation of methodology and "selected general schedule" career histories are detailed in: U. S. Congress. Senate. Committee on Governmental Affairs. Restructuring the Civil Service Retirement System: Analysis of Options to Control Costs and Maintain Retirement Income Security. Committee Print, 97d Cong., 1st Sess. Washington, U.S. Govt. Print. Off., 1982.

Source: Congressional Research Service.

TABLE III

Percentage of Gross and Net Preretirement Earnings Replaced
by an Indexed Annuity For Employees Retiring
at Age 55 with 30 years of service
(net in parenthesis)
(indexing = 4 percent annually)

Selected general schedule	Current CSRS	Value of benefits without participating in thrift	Value of benefits from employer contributions only	Full value of benefits including employee contributions
Low 55	53.4	14.8	19.7	24.7
	(73.9)	(20.3)	(26.1)	(31.7)
...... 62	53.4	43.0	48.0	52.9
	(65.2)	(59.7)	(65.5)	(71.1)
...... 70	53.4	43.0	48.0	52.9
	(64.2)	(60.1)	(66.4)	(72.2)
Mid 55	52.5	18.1	22.5	27.0
	(89.8)	(26.8)	(32.9)	(38.7)
...... 62	52.5	34.6	39.1	43.5
	(69.5)	(55.4)	(61.5)	(67.3)
...... 70	52.5	34.6	39.1	43.5
	(69.5)	(56.0)	(62.2)	(68.2)
High 55	53.4	24.6	30.2	35.9
	(92.3)	(35.9)	(43.1)	(50.0)
..... 62	53.4	41.0	46.6	52.3
	(70.5)	(64.6)	(71.9)	(78.8)
..... 70	53.4	41.0	46.6	52.3
	(70.6)	(65.3)	(72.7)	(79.7)
Postal ... 55	53.4	18.3	24.1	29.9
	(76.0)	(24.6)	(31.7)	(38.0)
... 62	53.4	48.3	54.1	59.9
	(65.8)	(67.8)	(74.5)	(81.1)
... 70	53.4	48.3	54.1	59.9
	(65.0)	(68.6)	(75.4)	(82.1)

Note: Assumes thrift plan of 100 percent employer match of employee contribution to 3 percent of salary. All economic assumptions, and documentation of methodology and "selected general schedule career" histories are detailed in: U. S. Congress. Senate. Committee on Governmental Affairs. Restructuring the Civil Service Retirement System: Analysis of Options to Control Costs and Maintain Retirement Income Security. Committee Print, 97d Cong., 1st Sess. Washington, U.S. Govt. Print. Off., 1982.

Source: Congressional Research Service.

TABLE IV

Percentage of Gross and Net Preretirement Earnings Replaced
by a Nonindexed Annuity For Employees Retiring
at Age 55 with 30 years of service
(net in parenthesis)

Selected general schedule	Current CSRS (indexed)	Value of benefits without participating in thrift	Value of benefits from employer contributions only	Full value of benefits including employee contributions
Low 55	53.4	22.0	29.3	36.6
	(73.9)	(28.7)	(36.9)	(45.1)
...... 62	53.4	44.9	50.5	56.1
	(65.2)	(62.0)	(68.4)	(74.7)
...... 70	53.4	40.4	44.5	48.6
	(64.2)	(56.5)	(62.2)	(67.1)
Mid 55	52.5	26.9	33.5	40.1
	(89.8)	(38.6)	(46.9)	(54.9)
...... 62	52.5	36.9	42.0	47.0
	(69.5)	(58.6)	(65.4)	(71.8)
...... 70	52.5	31.4	35.1	38.8
	(69.5)	(51.7)	(56.7)	(61.8)
High 55	53.4	36.5	44.9	53.3
	(92.3)	(50.8)	(60.7)	(70.0)
..... 62	53.4	44.2	50.5	56.9
	(70.5)	(68.7)	(76.6)	(84.4)
..... 70	53.4	36.7	41.4	46.0
	(70.6)	(59.4)	(65.8)	(71.9)
Postal ... 55	53.4	27.3	35.9	44.5
	(76.0)	(34.9)	(44.6)	(54.3)
... 62	53.4	50.7	57.2	63.8
	(65.8)	(70.5)	(78.0)	(85.4)
... 70	53.4	45.1	49.9	54.7
	(65.0)	(64.7)	(70.5)	(76.0)

Note: Assumes thrift plan of 100 percent match employer of employee contribution to 3 percent of salary. All economic assumptions, and documentation of methodology and "selected general schedule" career histories are detailed in: U. S. Congress. Senate. Committee on Governmental Affairs. Restructuring the Civil Service Retirement System: Analysis of Options to Control Costs and Maintain Retirement Income Security. Committee Print, 97d Cong., 1st Sess. Washington, U.S. Govt. Print. Off., 1982.

Source: Congressional Research Service.

IV. EXAMPLES OF SURVIVOR BENEFITS

Salary replacement rates for families of federal employees who die while working or after retirement are better, in most instances, under our plan than under the current system.

This is primarily because the survivor under social security receives from 72 percent to 100 percent of the annuitant's social security benefit after death. By contrast, the current Civil Service Retirement System continues only about 55 percent of the annuitant's benefit.

The tables that follow illustrate the replacement incomes for the survivors of federal employees who:

(1) Die while working (at age 35 after 10 years of service.)

(2) Die after retirement (at age 65 after 30 years of service.)

CASE 1.—INCOME FOR FAMILY OF EMPLOYEE DYING AT AGE 35 AFTER 10 YEARS OF SERVICE

[In percent]

	Current CSRS	Stevens plan					
		At death			At spouse age 60		
		Social security	Plan	Total	Social security	Plan	Total
Low-paid employee replacement income (percent of final salary):							
Spouse and 2 children	52.8	67.5	10.7	78.2	N.A.	N.A.	N.A.
Spouse only	20.7		10.7	10.7	26.1	3.7	29.8
High-paid employee replacement income (percent of final salary):							
Spouse and 2 children	30.1	33.3	13.0	46.3	N.A.	N.A.	N.A.
Spouse only	21.0		13.0	13.0	13.7	3.0	16.7

CASE 2.—INCOME FOR SPOUSE OF EMPLOYEE DYING AT AGE 65 AFTER 30 YEARS OF SERVICE

[In percent]

	Current CSRS	Stevens plan					
		At death			At spouse age 80		
		Social security	Plan	Total	Social security	Plan	Total
Low-paid employee	29.4	33.3	36.8	70.1	33.3	18.9	52.2
High-paid employee	29.3	18.5	53.6	72.1	18.5	27.5	46.0

Note.—Actuarial work by Edwin Hustead, Hay Associates.

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V. REPLACEMENT RATES BY THE GENERAL ACCOUNTING OFFICE

We asked the General Accounting Office to choose certain private forecasters' economic assumptions and to use them to project the retirement benefits under our plan and then to compare those projections to the benefits earned under the current system. GAO used three forecasters under four different age and service variations. Enclosure I describes the economic assumptions. Enclosure II provides gross replacement rates for an employee retiring at age 65 with 40 years of service. It shows a fixed annuity and an annuity indexed for the projected inflation rate. Enclosure III provides for replacement rates for the same age and service periods as Enclosure II but reduced for survivor benefits. Enclosure IV provides for replacement rates for the same age and service periods but indexes the annuity by four percent a year. Enclosure V provides for a fixed annuity for an individual retiring at age 55 with 30 years of service.

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FEDERAL PERSONNEL AND
COMPENSATION DIVISION

NOV 19 1982

The Honorable Ted Stevens
Chairman, Subcommittee on Civil Service,
Post Office, and General Services
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

At the request of your office, we calculated the estimated retirement income replacement rates shown in the enclosures.

Our calculations were based on the provisions of S. 2905, current social security provisions, and various assumptions specified by your staff. Your staff asked that assumptions regarding future rates of inflation, interest, and salary increases be based on current economic forecasts by Data Resources, Inc., Chase Econometric Models, and Wharton Econometric Forecasting Associates Models. The assumptions used in making our calculations are included in the enclosures.

We trust this information is satisfactory to the needs of your office.

Sincerely yours,

Clifford I. Gould

Clifford I. Gould
Director

Enclosures - 4

ASSUMPTIONS USED IN CALCULATING ESTIMATED REPLACEMENT RATES

The estimated replacement rates were calculated under three different sets of economic assumptions relating to future long-term annual rates of inflation, interest income, and salary increases. The assumptions were based on economic forecasts by Data Resources, Inc. (DRI), Chase Econometric Models, and Wharton Econometric Forecasting Associates Models. Based on DRI's forecasts, it was assumed that the future rates of inflation, salary increases, and interest would be 6.0 percent, 7.5 percent, and 8.5 percent, respectively. Based on Chase's forecasts, the same rates were assumed to be 6.5, 8.5, and 9.5 percent, respectively. Based on Wharton's forecasts, it was assumed the rates would be 7.5, 8.0, and 10.0 percent, respectively.

In determining the amount of the annual contribution under each example, it was assumed that the Government contributed 9 percent of salary up to $20,000 and 16 percent of salary in excess of $20,000. The $20,000 "break-point" was indexed to annual salary increases. To avoid the complications of forecasting and timing promotions and within-grade increases, no salary increases were assumed other than the level annual rates mentioned above.

In the examples involving the thrift plan, it was assumed that employees contributed 3 percent of their annual salary to the plan and the Government matched the contributions.

Estimated social security benefits under each example are approximate and were based on the Social Security Administration's projections of minimum, average, and maximum benefits in the next 40 years. We modified the projections to fit our illustrative examples and economic assumptions.

In each example, annuity values were based on the 1971 Group Annuity Mortality Table.

COMPARISON OF RETIREMENT INCOME REPLACEMENT RATES UNDER CIVIL SERVICE RETIREMENT SYSTEM AND S. 2905 FOR A MALE EMPLOYEE RETIRING AT AGE 65 WITH 40 YEARS SERVICE a/

(Economic assumptions: Inflation 6.0 percent, Salary increases 7.5 percent, Interest income 8.5 percent)

Age		Civil service system b/	S. 2905 Level annual annuity plus social security	S. 2905 Adjusted annual annuity plus social security c/
	$10,000 Starting Salary			
65	Without thrift plan	71.1	142.9	122.3
	With thrift plan	-	182.6	148.2
70	Without thrift plan	71.1	130.6	122.3
	With thrift plan	-	161.9	148.2
80	Without thrift plan	71.1	109.7	122.3
	With thrift plan	-	127.3	148.2
	$20,000 Starting Salary			
65	Without thrift plan	71.1	122.0	101.4
	With thrift plan	-	161.7	127.3
70	Without thrift plan	71.1	109.7	101.4
	With thrift plan	-	141.1	127.3
80	Without thrift plan	71.1	88.9	101.4
	With thrift plan	-	106.4	127.3
	$30,000 Starting Salary			
65	Without thrift plan	71.1	127.5	101.6
	With thrift plan	-	167.2	127.5
70	Without thrift plan	71.1	112.0	101.6
	With thrift plan	-	143.4	127.5
80	Without thrift plan	71.1	85.8	101.6
	With thrift plan	-	103.3	127.5

a/Replacement rates represent the ratio of retirement income, including social security benefits where applicable, to the employee's final year's gross salary. At ages beyond retirement, final salary was adjusted to reflect the effect of the assumed rate of inflation.

b/Under present law, both civil service and social security benefits are adjusted annually for inflation.

c/Represents rate of replacement if employee elected to have annuity increased annually by the indicated, assumed rate of inflation.

COMPARISON OF RETIREMENT INCOME REPLACEMENT RATES
UNDER CIVIL SERVICE RETIREMENT SYSTEM AND S. 2905
FOR A MALE EMPLOYEE RETIRING AT AGE 65 WITH
40 YEARS SERVICE a/

(Economic assumptions: Inflation 6.5 percent, Salary increases 8.5 percent, Interest income 9.5 percent).

Age		Civil service system b/	S. 2905: Level annual annuity plus social security	S. 2905: Adjusted annual annuity plus social security c/
		$10,000 Starting Salary		
65	Without thrift plan	70.4	140.1	117.5
	With thrift plan	-	182.3	144.6
70	Without thrift plan	70.4	126.0	117.5
	With thrift plan	-	158.8	144.6
80	Without thrift plan	70.4	103.0	117.5
	With thrift plan	-	120.5	144.6
		$20,000 Starting Salary		
65	Without thrift plan	70.4	121.4	98.8
	With thrift plan	-	163.6	126.0
70	Without thrift plan	70.4	107.3	98.8
	With thrift plan	-	140.1	126.0
80	Without thrift plan	70.4	84.3	98.8
	With thrift plan	-	101.8	126.0
		$30,000 Starting Salary		
65	Without thrift plan	70.4	128.7	100.2
	With thrift plan	-	170.9	127.4
70	Without thrift plan	70.4	110.9	100.2
	With thrift plan	-	143.7	127.4
80	Without thrift plan	70.4	82.0	100.2
	With thrift plan	-	99.5	127.4

a/Replacement rates represent the ratio of retirement income, including social security benefits where applicable, to the employee's final year's gross salary. At ages beyond retirement, final salary was adjusted to reflect the effect of the assumed rate of inflation.

b/Under present law, both civil service and social security benefits are adjusted annually for inflation.

c/Represents rate of replacement if employee elected to have annuity increased annually by the indicated, assumed rate of inflation.

COMPARISON OF RETIREMENT INCOME REPLACEMENT RATES
UNDER CIVIL SERVICE RETIREMENT SYSTEM AND S. 2905
FOR A MALE EMPLOYEE RETIRING AT AGE 65 WITH
40 YEARS SERVICE a/

(Economic assumptions: Inflation 7.5 percent, Salary increases 8.0 percent, Interest income 10.0 percent)

Age		Civil service system b/	S. 2905: Level annual annuity plus social security	S. 2905: Adjusted annual annuity plus social security c/
		$10,000 Starting Salary		
65	Without thrift plan	70.7	160.0	128.2
	With thrift plan	-	213.0	160.0
70	Without thrift plan	70.7	140.0	128.2
	With thrift plan	-	179.7	160.0
80	Without thrift plan	70.7	109.4	128.2
	With thrift plan	-	128.7	160.0
		$20,000 Starting Salary		
65	Without thrift plan	70.7	140.4	108.6
	With thrift plan	-	193.3	140.4
70	Without thrift plan	70.7	120.4	108.6
	With thrift plan	-	160.1	140.4
80	Without thrift plan	70.7	89.8	108.6
	With thrift plan	-	109.0	140.4
		$30,000 Starting Salary		
65	Without thrift plan	70.7	151.4	111.4
	With thrift plan	-	204.4	143.2
70	Without thrift plan	70.7	126.3	111.4
	With thrift plan	-	166.0	143.2
80	Without thrift plan	70.7	87.7	111.4
	With thrift plan	-	107.0	143.2

a/Replacement rates represent the ratio of retirement income, including social security benefits where applicable, to the employee's final year's gross salary. At ages beyond retirement, final salary was adjusted to reflect the effect of the assumed rate of inflation.

b/Under present law, both civil service and social security benefits are adjusted annually for inflation.

c/Represents rate of replacement if employee elected to have annuity increased annually by the indicated, assumed rate of inflation.

ENCLOSURE III

COMPARISON OF RETIREMENT INCOME REPLACEMENT RATES
UNDER CIVIL SERVICE RETIREMENT SYSTEM AND S. 2905
FOR A MALE EMPLOYEE RETIRING AT AGE 65 WITH 40 YEARS
SERVICE, ADJUSTED TO PROVIDE SURVIVOR BENEFITS a/

(Economic assumptions: Inflation 6.0 percent, Salary increases 7.5 percent, Interest income 8.5 percent)

Age		Civil service system b/	S. 2905 Level annual annuity plus social security	S. 2905 Adjusted annual annuity plus social security c/
		$10,000 Starting Salary		
65	Without thrift plan	64.1	134.8	114.8
	With thrift plan	-	169.1	135.7
70	Without thrift plan	64.1	121.8	114.8
	With thrift plan	-	148.9	135.7
80	Without thrift plan	64.1	104.9	114.8
	With thrift plan	-	120.1	135.7
		$20,000 Starting Salary		
65	Without thrift plan	64.0	114.0	94.0
	With thrift plan	-	148.3	114.9
70	Without thrift plan	64.0	101.0	94.0
	With thrift plan	-	128.2	114.9
80	Without thrift plan	64.0	84.0	94.0
	With thrift plan	-	99.1	114.9
		$30,000 Starting Salary		
65	Without thrift plan	64.0	117.4	92.2
	With thrift plan	-	151.7	113.1
70	Without thrift plan	64.0	101.0	92.2
	With thrift plan	-	128.2	113.1
80	Without thrift plan	64.0	79.7	92.2
	With thrift plan	-	94.8	113.1

a/Replacement rates represent the ratio of retirement income, including social security benefits where applicable, to the employee's final year's gross salary. At ages beyond retirement, final salary was adjusted to reflect the effect of the assumed rate of inflation. The survivor benefit will be 55 percent of the retiree's annuity provided by the defined contribution plan and/or the thrift plan.

b/Under present law, both civil service and social security benefits are adjusted annually for inflation.

c/Represents rate of replacement if employee elected to have annuity increased annually by the indicated assumed rate of inflation.

COMPARISON OF RETIREMENT INCOME REPLACEMENT RATES
UNDER CIVIL SERVICE RETIREMENT SYSTEM AND S. 2905
FOR A MALE EMPLOYEE RETIRING AT AGE 65 WITH 40 YEARS
SERVICE, ADJUSTED TO PROVIDE SURVIVOR BENEFITS a/

(Economic assumptions: Inflation 6.5 percent, Salary increases 8.5 percent, Interest income 9.5 percent)

Age		Civil service system b/	S. 2905: Level annual annuity plus social security	S. 2905: Adjusted annual annuity plus social security c/
	$10,000 Starting Salary			
65	Without thrift plan	63.5	132.0	109.9
	With thrift plan	-	168.8	131.9
70	Without thrift plan	63.5	117.1	109.9
	With thrift plan	-	145.7	131.9
80	Without thrift plan	63.5	98.3	109.9
	With thrift plan	-	113.6	131.9
	$20,000 Starting Salary			
65	Without thrift plan	63.4	113.4	91.2
	With thrift plan	-	150.2	113.2
70	Without thrift plan	63.4	98.4	91.2
	With thrift plan	-	127.0	113.2
80	Without thrift plan	63.4	79.6	91.2
	With thrift plan	-	94.9	113.2
	$30,000 Starting Salary			
65	Without thrift plan	63.4	118.5	90.7
	With thrift plan	-	155.3	112.7
70	Without thrift plan	63.4	99.7	90.7
	With thrift plan	-	120.3	112.7
80	Without thrift plan	63.4	76.0	90.7
	With thrift plan	-	91.3	112.7

a/Replacement rates represent the ratio of retirement income, including social security benefits where applicable, to the employee's final year's gross salary. At ages beyond retirement, final salary was adjusted to reflect the effect of the assumed rate of inflation. The survivor benefit will be 55 percent of the retiree's annuity provided by the defined contribution plan and/or the thrift plan.

b/Under present law, both civil service and social security benefits are adjusted annually for inflation.

c/Represents rate of replacement if employee elected to have annuity increased annually by the indicated assumed rate of inflation.

COMPARISON OF RETIREMENT INCOME REPLACEMENT RATES UNDER CIVIL SERVICE RETIREMENT SYSTEM AND S. 2905 FOR A MALE EMPLOYEE RETIRING AT AGE 65 WITH 40 YEARS SERVICE, ADJUSTED TO PROVIDE SURVIVOR BENEFITS a/

(Economic assumptions: Inflation 7.5 percent, Salary increases 8.0 percent, Interest income 10.0 percent)

Age		Civil service system b/	S. 2905: Level annual annuity plus social security	S. 2905: Adjusted annual annuity plus social security c/
		$10,000 Starting Salary		
65	Without thrift plan	63.8	150.2	119.1
	With thrift plan	-	196.6	144.8
70	Without thrift plan	63.8	129.0	119.1
	With thrift plan	-	163.8	144.8
80	Without thrift plan	63.8	104.1	119.1
	With thrift plan	-	121.0	144.8
		$20,000 Starting Salary		
65	Without thrift plan	63.7	130.5	99.5
	With thrift plan	-	176.9	125.2
70	Without thrift plan	63.7	109.4	99.5
	With thrift plan	-	144.2	125.2
80	Without thrift plan	63.7	84.4	99.5
	With thrift plan	-	101.2	125.2
		$30,000 Starting Salary		
65	Without thrift plan	63.7	139.0	100.0
	With thrift plan	-	185.4	125.7
70	Without thrift plan	63.7	112.4	100.0
	With thrift plan	-	147.2	125.7
80	Without thrift plan	63.7	81.0	100.0
	With thrift plan	-	97.9	125.7

a/Replacement rates represent the ratio of retirement income, including social security benefits where applicable, to the employee's final year's gross salary. At ages beyond retirement, final salary was adjusted to reflect the effect of the assumed rate of inflation. The survivor benefit will be 55 percent of the retiree's annuity provided by the defined contribution plan and/or the thrift plan.

b/Under present law, both civil service and social security benefits are adjusted annually for inflation.

c/Represents rate of replacement if employee elected to have annuity increased annually by the indicated assumed rate of inflation.

COMPARISON OF RETIREMENT INCOME REPLACEMENT RATES
UNDER CIVIL SERVICE RETIREMENT SYSTEM AND S. 2905
FOR A MALE EMPLOYEE RETIRING AT AGE 65 WITH
40 YEARS SERVICE a/

(Economic assumptions: Inflation 6.0 percent, Salary increases 7.5 percent, Interest income 8.5 percent)

Age		Civil service system b/	S. 2905 Level annual annuity plus social security	S. 2905 Adjusted annual annuity plus social security c/
		$10,000 Starting Salary		
65	Without thrift plan	71.1	142.9	129.2
	With thrift plan	-	182.6	159.7
70	Without thrift plan	71.1	130.6	125.1
	With thrift plan	-	161.9	152.8
80	Without thrift plan	71.1	109.7	118.1
	With thrift plan	-	127.3	141.2
		$20,000 Starting Salary		
65	Without thrift plan	71.1	122.0	108.3
	With thrift plan	-	161.7	138.8
70	Without thrift plan	71.1	109.7	104.2
	With thrift plan	-	141.1	131.9
80	Without thrift plan	71.1	88.9	97.2
	With thrift plan	-	106.4	120.3
		$30,000 Starting Salary		
65	Without thrift plan	71.1	127.5	110.2
	With thrift plan	-	167.2	140.7
70	Without thrift plan	71.1	112.0	105.1
	With thrift plan	-	143.4	132.8
80	Without thrift plan	71.1	85.8	96.3
	With thrift plan	-	103.3	119.4

a/Replacement rates represent the ratio of retirement income, including social security benefits where applicable, to the employee's final year's gross salary. At ages beyond retirement, final salary was adjusted to reflect the effect of the assumed rate of inflation.

b/Under present law, both civil service and social security benefits are adjusted annually for inflation.

c/Represents rate of replacement assuming employee elected to have annuity increased annually by 4 percent.

COMPARISON OF RETIREMENT INCOME REPLACEMENT RATES
UNDER CIVIL SERVICE RETIREMENT SYSTEM AND S. 2905
FOR A MALE EMPLOYEE RETIRING AT AGE 65 WITH
40 YEARS SERVICE a/

(Economic assumptions: Inflation 6.5 percent, Salary increases 8.5 percent, Interest income 9.5 percent)

Age		Civil service system b/	S. 2905: Level annual annuity plus social security	S. 2905: Adjusted annual annuity plus social security c/
		$10,000 Starting Salary		
65	Without thrift plan	70.4	140.1	126.2
	With thrift plan	-	182.3	159.1
70	Without thrift plan	70.4	126.0	120.8
	With thrift plan	-	158.8	150.1
80	Without thrift plan	70.4	103.0	111.9
	With thrift plan	-	120.5	135.3
		$20,000 Starting Salary		
65	Without thrift plan	70.4	121.4	107.5
	With thrift plan	-	163.6	140.5
70	Without thrift plan	70.4	107.3	102.1
	With thrift plan	-	140.1	131.4
80	Without thrift plan	70.4	84.3	93.2
	With thrift plan	-	101.8	116.7
		$30,000 Starting Salary		
65	Without thrift plan	70.4	128.7	111.2
	With thrift plan	-	170.9	144.1
70	Without thrift plan	70.4	110.9	104.3
	With thrift plan	-	143.7	133.7
80	Without thrift plan	70.4	82.0	93.2
	With thrift plan	-	99.5	116.7

a/Replacement rates represent the ratio of retirement income, including social security benefits where applicable, to the employee's final year's gross salary. At ages beyond retirement, final salary was adjusted to reflect the effect of the assumed rate of inflation.

b/Under present law, both civil service and social security benefits are adjusted annually for inflation.

c/Represents rate of replacement assuming employee elected to have annuity increased annually by 4 percent.

COMPARISON OF RETIREMENT INCOME REPLACEMENT RATES UNDER CIVIL SERVICE RETIREMENT SYSTEM AND S. 2905 FOR A MALE EMPLOYEE RETIRING AT AGE 65 WITH 40 YEARS SERVICE a/

(Economic assumptions: Inflation 7.5 percent, Salary increases 8.0 percent, Interest income 10.0 percent)

Age		Civil service system b/	S. 2905: Level annual annuity plus social security	S. 2905: Adjusted annual annuity plus social security c/
		$10,000 Starting Salary		
65	Without thrift plan	70.7	160.0	143.0
	With thrift plan	-	213.0	184.7
70	Without thrift plan	70.7	140.0	133.7
	With thrift plan	-	179.7	169.2
80	Without thrift plan	70.7	109.4	119.4
	With thrift plan	-	128.7	145.4
		$20,000 Starting Salary		
65	Without thrift plan	70.7	140.4	123.4
	With thrift plan	-	193.3	165.1
70	Without thrift plan	70.7	120.4	114.1
	With thrift plan	-	160.1	149.6
80	Without thrift plan	70.7	89.8	99.8
	With thrift plan	-	109.0	125.7
		$30,000 Starting Salary		
65	Without thrift plan	70.7	151.4	130.1
	With thrift plan	-	204.4	171.8
70	Without thrift plan	70.7	126.3	118.4
	With thrift plan	-	166.0	153.8
80	Without thrift plan	70.7	87.7	100.3
	With thrift plan	-	107.0	126.3

a/Replacement rates represent the ratio of retirement income, including social security benefits where applicable, to the employee's final year's gross salary. At ages beyond retirement, final salary was adjusted to reflect the effect of the assumed rate of inflation.

b/Under present law, both civil service and social security benefits are adjusted annually for inflation.

c/Represents rate of replacement assuming employee elected to have annuity increased annually by 4 percent.

COMPARISON OF RETIREMENT INCOME REPLACEMENT RATES UNDER CIVIL SERVICE RETIREMENT SYSTEM AND S. 2905 FOR A MALE EMPLOYEE RETIRING AT AGE 55 WITH 30 YEARS SERVICE a/

(Economic assumptions: Inflation 6.0 percent, Salary increases 7.5 percent, Interest income 8.5 percent)

Age		Civil service system b/	S. 2905 Level annual annuity plus social security c/
		$10,000 Starting Salary	
55	Without thrift plan	52.4	34.9
	With thrift plan	-	58.1
62	Without thrift plan	52.4	82.7
	With thrift plan	-	98.1
65	Without thrift plan	52.4	78.9
	With thrift plan	-	91.9
70	Without thrift plan	52.4	74.0
	With thrift plan	-	83.7
80	Without thrift plan	52.4	67.6
	With thrift plan	-	73.0
		$20,000 Starting Salary	
55	Without thrift plan	52.4	34.9
	With thrift plan	-	58.1
62	Without thrift plan	52.4	69.9
	With thrift plan	-	85.4
65	Without thrift plan	52.4	66.2
	With thrift plan	-	79.2
70	Without thrift plan	52.4	61.3
	With thrift plan	-	71.0
80	Without thrift plan	52.4	54.8
	With thrift plan	-	60.3
		$30,000 Starting Salary	
55	Without thrift plan	52.4	43.9
	With thrift plan	-	67.2
62	Without thrift plan	52.4	67.8
	With thrift plan	-	83.3
65	Without thrift plan	52.4	63.1
	With thrift plan	-	76.1
70	Without thrift plan	52.4	57.0
	With thrift plan	-	66.7
80	Without thrift plan	52.4	48.9
	With thrift plan	-	54.3

a/Replacement rates represent the ratio of retirement income, including social security benefits where applicable, to the employee's final year's gross salary. At ages beyond retirement, final salary was adjusted to reflect the effect of the assumed rate of inflation.

b/Under present law, both civil service and social security benefits are adjusted annually for inflation.

c/Social security benefits are assumed to begin at age 62.

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COMPARISON OF RETIREMENT INCOME REPLACEMENT RATES UNDER CIVIL SERVICE RETIREMENT SYSTEM AND S. 2905 FOR A MALE EMPLOYEE RETIRING AT AGE 55 WITH 30 YEARS SERVICE a/

(Economic assumptions: Inflation 6.5 percent, Salary increases 8.5 percent, Interest income 9.5 percent)

Age		Civil service system b/	S. 2905 Level annual annuity plus social security c/
			$10,000 Starting Salary
55	Without thrift plan	52.0	37.6
	With thrift plan	-	62.7
62	Without thrift plan	52.0	78.8
	With thrift plan	-	95.0
65	Without thrift plan	52.0	74.7
	With thrift plan	-	88.0
70	Without thrift plan	52.0	69.2
	With thrift plan	-	79.0
80	Without thrift plan	52.0	62.4
	With thrift plan	-	67.6
			$20,000 Starting Salary
55	Without thrift plan	52.0	37.6
	With thrift plan	-	62.7
62	Without thrift plan	52.0	67.6
	With thrift plan	-	83.7
65	Without thrift plan	52.0	63.4
	With thrift plan	-	76.8
70	Without thrift plan	52.0	58.0
	With thrift plan	-	67.8
80	Without thrift plan	52.0	51.2
	With thrift plan	-	56.4
			$30,000 Starting Salary
55	Without thrift plan	52.0	47.4
	With thrift plan	-	72.5
62	Without thrift plan	52.0	66.1
	With thrift plan	-	82.3
65	Without thrift plan	52.0	60.9
	With thrift plan	-	74.2
70	Without thrift plan	52.0	54.1
	With thrift plan	-	63.8
80	Without thrift plan	52.0	45.4
	With thrift plan	-	50.6

ENCLOSURE V

a/Replacement rates represent the ratio of retirement income, including social security benefits where applicable, to the employee's final year's gross salary. At ages beyond retirement, final salary was adjusted to reflect the effect of the assumed rate of inflation.

b/Under present law, both civil service and social security benefits are adjusted annually for inflation.

c/Social security benefits are assumed to begin at age 62.

COMPARISON OF RETIREMENT INCOME REPLACEMENT RATES UNDER CIVIL SERVICE RETIREMENT SYSTEM AND S. 2905 FOR A MALE EMPLOYEE RETIRING AT AGE 55 WITH 30 YEARS SERVICE a/

(Economic assumptions: Inflation 7.5 percent, Salary increases 8.0 percent, Interest income 10.0 percent)

Age		Civil service system b/	S. 2905 Level annual annuity plus social security c/
		$10,000 Starting Salary	
55	Without thrift plan	52.2	45.2
	With thrift plan	-	75.2
62	Without thrift plan	52.2	84.5
	With thrift plan	-	102.6
65	Without thrift plan	52.2	79.2
	With thrift plan	-	93.8
70	Without thrift plan	52.2	72.6
	With thrift plan	-	82.8
80	Without thrift plan	52.2	64.7
	With thrift plan	-	69.7
		$20,000 Starting Salary	
55	Without thrift plan	52.2	45.2
	With thrift plan	-	75.2
62	Without thrift plan	52.2	72.6
	With thrift plan	-	90.7
65	Without thrift plan	52.2	67.3
	With thrift plan	-	81.9
70	Without thrift plan	52.2	60.7
	With thrift plan	-	70.8
80	Without thrift plan	52.2	52.8
	With thrift plan	-	57.7
		$30,000 Starting Salary	
55	Without thrift plan	52.2	56.8
	With thrift plan	-	87.0
62	Without thrift plan	52.2	71.9
	With thrift plan	-	90.0
65	Without thrift plan	52.2	65.2
	With thrift plan	-	79.8
70	Without thrift plan	52.2	56.9
	With thrift plan	-	67.0
80	Without thrift plan	52.2	47.0
	With thrift plan	-	52.0

a/Replacement rates represent the ratio of retirement income, including social security benefits where applicable, to the employee's final year's gross salary. At ages beyond retirement, final salary was adjusted to reflect the effect of the assumed rate of inflation.

b/Under present law, both civil service and social security benefits are adjusted annually for inflation.

c/Social security benefits are assumed to begin at age 62.

VI. COST ANALYSIS

The following paper by Sylvester Schieber of the Employee Benefit Research Institute compares in great detail the cost of the current system versus our plan. It shows the overall impact on the federal budget as well as the various internal funding transactions. The one major caveat to this paper is the omission of the impact of private investment of the new trust fund on the federal budget. Private investment of trust fund monies will require additional government outlays in the earlier years. However, in later years the private investment of these funds will significantly reduce the government's cost. Following this paper is a section comprised of budgetary flow charts. These charts show the additional budgetary impact of private investment

THE COST AND FUNDING IMPLICATIONS OF MODIFYING THE CIVIL SERVICE RETIREMENT SYSTEM

by

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The views presented here are those of the author and do not necessarily reflect the views of the Employee Benefit Research Institute, its Trustees, members or other staff.

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The public discussion of mandatory Social Security coverage of Federal workers often focuses on the beneficial effects for Social Security. Mandatory coverage critics, on the other hand, argue that covering Federal workers will raise the cost of Federal civilian retirement programs and threaten the viability of their retirement trust funds. This paper provides an analysis of the potential effect that Social Security coverage of Federal workers would have on the cost of the Federal Civil Service Retirement Program, the Federal budgetary effect of such a measure and the long term implications for the trust funds.

THE COORDINATION PROPOSAL

In order for a discussion of this sort to be meaningful it has to be concrete. This analysis focuses on an option discussed in a recent report issued by the Congressional Research Service. 1/ The option used in the analysis is Option IV-A from their report. This option was chosen because it closely parallels the option included in draft legislation prepared by Senator Ted Stevens of Alaska.

The analysis assumes that all workers hired into Federal Civilian jobs after January 1, 1983 would be covered by Social Security. They would also be covered by a defined contribution plan that would be financed solely by employer contributions. This plan would provide contributions of 9 percent on the first $20,000 of salary and 16 percent above that. The $20,000 would be indexed by increases in the general wage schedule over time. In addition to the basic benefit, a supplemental thrift plan would also be available for those

1/ Congressional Research Service, Restructuring the Civil Service Retirement System Analysis: Analysis of Options to Control Costs and Maintain Retirement Income Security (Washington, D.C.: GPO, 1982).

covered under the new plan. This would allow the employee to contribute up to 6 percent of salary into the plan and would be fully matched by the employer. The Stevens' bill would fully match employee contributions up to 3 percent of salary. This element of the Stevens' bill would reduce the cost estimates presented. On the other hand, the Stevens' bill would provide contributions based on military service, raising costs compared to the option considered here. The option discussed here and the Stevens' bill would also modify the Federal employee sick leave and disability program to coordinate with Social Security.

THE CURRENT CSRS PROGRAM

The cost of CSRS can be considered from different perspectives. One common way to estimate the cost of a retirement program is to use what actuaries call the "entry age normal cost method." This method estimates the percentage of a worker's salary that would have to be set aside each year to fully fund benefit entitlements by retirement. Aggregating the normal cost of all workers provides an estimate of the employer's total normal cost. As with most estimates the normal cost estimate is sensitive to the assumptions on which it is based. This is clear in Table 1, where two different sets of economic assumptions are used to estimate the normal cost of the CSRS program. The greatest variance in assumptions for the two estimates is in inflation, although it is the inflation/interest differential that is most significant in explaining the variance in the normal cost estimates. The real interest rate, or return on assets under the II-B assumptions is twice that under the Board of Actuaries' assumptions. Higher interest rates raise investment income over time and increase the degree to which the trust fund supports benefits.

Since employees covered by CSRS contribute 7 percent of salary to the retirement program this means the employer (i.e., the Government's) cost of the

TABLE I

Effect of Economic Assumptions on CSRS Cost Estimates

	Interest	Wage Growth	Inflation	Normal Cost
CSRS Board of Actuaries	6.0	5.5	5	36.46
Social Security 1981, II-B	6.1	5.5	4	31.23

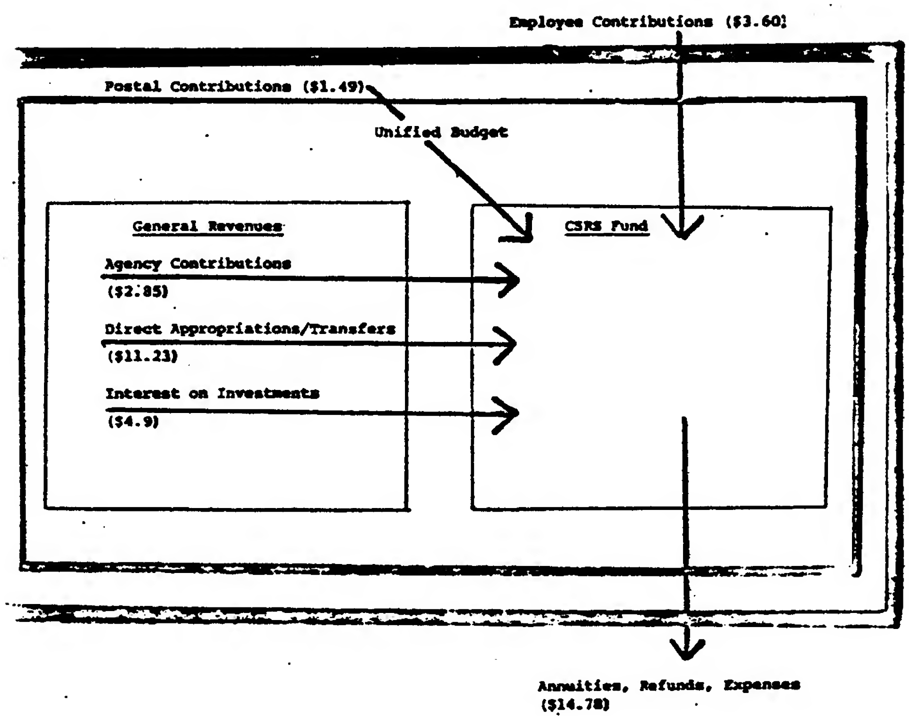
program is 29.46 or 24.23 percent of payroll depending on which set of assumptions are used. Since this discussion is focusing on Social Security coverage costs the Social Security assumptions are used for the remainder of the discussion.

The normal cost measure is a useful concept because it gives a good perspective on the generosity of the retirement program in comparison to pensions established by other employers. For example, in the private sector, employer normal costs for retirement programs generally run about 7 to 12 percent of payroll on top of Social Security. The normal cost is also useful because it is indicative of the portion of lifetime benefits paid to workers in the form of deferred retirement income.

An alternative way to evaluate the cost of CSRS is to look at the cost on a budget basis. This is useful because it reflects the relative cost of Federal retirement for taxpayers and participants. Figure 1 pictorially represents the operation of the CSRS during fiscal 1980. The budget box represents the total Federal budget components of the CSRS. It includes the off-budget Postal Service. The first inner box represents the unified budget. The arrows represent the budgetary flows relevant to CSRS. All transactions which cross the outermost box affect the total cost of CSRS. Transactions crossing the largest interior box affect the unified budget.

Figure 1

Flow of Funds Related to
The Civil Service Retirement System
(1980 amounts in billions)



SOURCE: Budget of the United States Government Fiscal Year 1982, Appendix p.I-V118.

The implication of this depiction is that most of the funding of CSRS is internal to the unified budget. Even the Postal Service contributions fall conceptually within the unified budget framework. If USPS increased their contributions it could ultimately lead to higher postage rates or general revenue support of that off-budget account. In either case the cost would be borne by the public. In terms of total Federal outlays in 1980, benefits and refunds amounted to $14.78 billion while employee contributions were $3.60 billion. The 1980 USPS contribution was split between the normal 7 percent agency contribution ($775 million) and the obligations ($714 million) vis-a-vis unfunded liabilities. Since USPS is off budget their contributions do affect the unified budget net costs of the program but not total outlays from the taxpayers' perspective. In short the taxpayer cost of CSRS is equal to total benefits plus contribution refunds minus employee contributions. In 1980 this was ($14.78 billion minus $3.60 billion) $11.18 billion.

The example also raises another important point in regard to funding CSRS liabilities. A great deal of concern has been voiced over the unfunded liabilities of CSRS. The total liabilities of the system exist because of the statutes that define the program. To the extent the system holds government securities as its funding instruments it has a contractual promise from the goverment (IOUs) that certain resources will be available to meet benefit payments as required. The unfunded liabilities, on the other hand, are statutory promises that have arisen because benefits accrued under the law have not been matched by a comparable pool of assets (i.e., Government IOUs). If the statutory liabilities were converted to contractual obligations, it would not affect benefit levels because they are separately defined by statute. The important point is that there be a funding mechanism available to meet these

benefits as they come due. Even though the current system has sizeable unfunded liabilities, the current funding method assures benefits for the forseeable future.

However, the budgetary process would allow more rapid funding of CSRS liabilities than now occurs without having an adverse affect on taxpayers. An added annual contribution, say $20 billion, would be an increase in general revenue expenditures but would be exactly offset by an increase in CSRS income. The U.S. government would increase its bond issues by $20 billion but these would be offset by a $20 billion increase in CSRS funds. There would be no impact on the taxpayers.

This is not to suggest that CSRS should be funded instantaneously, or that the unfunded liability should be ignored. The presence of a fully funded system could well lead to pressure for benefit increases which would, in turn, increase the taxpayers' cost. On the other hand, the unfunded liability is a real cost that will eventually have to be covered.

There are three important variables to consider in the context of CSRS reform. These are: First, what is the effect on the level and distribution of benefits?; Second, what are the budgetary implications of the proposal -- both long and short-term?; and third, what must be done to assure that benefit promises to existing employees are met during a transition to the new system?

The first of these questions is analyzed in detail in the CRS study cited in footnote 1. The latter two questions are analyzed below.

BUDGETARY IMPLICATIONS OF CHANGING CSRS

The above discussion suggests that CSRS budgetary effects could be described by the following formula:

(1) CSRS Budgetary Cost = benefits + refunds minus employee contributions.

Table 2 shows the long-term projected costs of the CSRS if the program is not modified.

In addition to the basic CSRS costs the budget is also affected by Social Security windfall benefits paid to individuals covered by CSRS. The annual magnitude of these windfalls for Federal workers and annuitants has been estimated to have been roughly $1 billion in 1980. 2/ For the sake of this analysis, this estimate is indexed by the CPI assumptions used to estimate the future cost of CSRS benefits. There are several reasons to believe this is a conservative estimate. First, the number of CSRS beneficiaries is growing rapidly and will continue to do so throughout this decade. This will increase the prevalence of windfalls. Second, initial Social Security benefits are based on indexed wages and the benefit formula itself raises benefits over time because the bend points in the formula are themselves indexed. In coming years this should increase initial entitlements and windfalls for short-coverage workers more rapidly than prices increase. Finally, once benefits commence they are indexed by the CPI. This indexation also applies to windfalls.

Because the current system gives rise to these Social Security windfalls they should be considered in any cost estimates of present policy. This total cost can be derived mathematically as follows:

(2) Current System Total Cost = CSRS budgetary cost + SS windfalls

The combined CSRS cost plus the Social Security windfalls are shown in

2/ See Sylvester J. Schieber, Universal Social Security Coverage and Alternatives: The Benefits and Costs (Washington, D.C.: EBRI, 1982).

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Table 3. 3/

The proposed modification to the system analyzed here calls for Social Security coverage coordinated with a modified Federal pension for new Federal employees beginning in 1983. That means that the ongoing costs of the total system have to be estimated separately for the closed system that applies to old hires, and for the new system covering future employees. The budgetary costs of the separate systems can be aggregated to get the combined systems cost.

The total budgetary impact of modifying CSRS would be different than the effect on the various accounts taken separately. Both CSRS and Social Security are now within the unified budget. Because the proposal analyzed here would segregate the old and new systems the costs for the various accounts can be considered as follows:

(3) Closed CSRS Costs = benefits (old) + refunds minus employee contributions

(4) New CSRS Costs = benefits (new) + refunds minus employee contributions

(5) Social Security Costs = benefits (SS) minus employee contributions

3/ While the costs of Social Security windfalls are added here to the current system total cost they are not included in the current system, cost in comparisons with the modified system. The Stevens' bill does not include any explicit windfall reduction provisions so they are not considered. It should be noted, however, that the Stevens' bill would gradually eliminate the windfall phenomenon for Federal workers and result in real savings to taxpayers.

(6) Total Budget Cost = old CSRS cost + new CSRS cost + Social Security cost

Equation (3) is essentially the same as equation (1) discussed earlier that applies to the current system. The difference is that equation (3) applies only to those workers on the payroll or individuals entitled to CSRS benefits (receiving or deferred) on the assumed date the modified system would be put into operation. Equation (1), on the other hand, assumed future new workers would continue to be covered under the current system. Table 4 presents the annual budgetary flows specifically related to the closed CSRS system under the proposal being analyzed.

Equation (4) represents the budgetary cost of the new Federal retirement program. It is the counterpart of equation (3). The flows in this account are shown in Table 5. The very sizeable refunds that develop under the modified system are the result of the improved vesting provisions in the Stevens' proposal. Under the current CSRS more than 20 percent of today's Federal work force, is now or will become vested but, will leave Federal employment and withdraw their own contributions and receive no benefit from CSRS. While these workers will be technically vested under the definitions of the plan at some point they will ultimately have no practical vested right to an employer-provided benefit. Under the modified system such employees would vest in a real sense. As they leave Federal employment they would be able to roll their vested benefits out into an IRA or other retirement program. This would represent a significant benefit improvement for workers who spend several years in Federal employment but do not make it their full career.

Equations (3) and (4) and Tables 4 and 5 are based on the assumption that the new system's trust fund would be segregated from the current system's. This would not necessarily have to be the case. The reason the Federal retirement account is split in this analysis is that the Stevens' bill provides that the new system would ultimately be funded through private securities markets. The two funds could be combined for either budgetary or practical purposes, however. Even if this were done, the combined fund could still hold a portion of its portfolio in private securities. Table 6 reflects the budgetary flows required if the funds were combined.

Equation (5) shows the budgetary effects of Social Security coverage of new hires. Again the budgetary effect is different than the effect on the OASDHI accounts. The difference is that the specific account would be credited for both employer and employee contributions. The affect on these accounts is shown in Table 7 as the "Net Social Security Revenue Increase." Since Social Security is in the unified budget the employer contribution would show up as an expense in one section of the budget and as equal trust fund income at a different place. The two would net each other out. The budgetary flows reflected in equation (5) are shown in the right hand column of Table 7.

If Social Security is taken out of the unified budget it would change the analysis conceptually without affecting the practical result. For example, if Social Security were an off-budget account, the employer contribution would then show up as a real budget expense. The contribution would show up as income to an off-budget account. The budgetary and off-budget accounts would both still be Federal accounts, however. While taking Social Security off-budget would change the bookkeeping it would not change the overall fiscal position of the Federal government if coverage were extended to Federal workers.

The total budgetary cost, modifying CSRS as considered here, can be calculated according to equation (6). The budgetary flows are shown in Table 8 based on this calculation. They become meaningful in comparison to the budgetary cost of the current system which was shown in Table 2.

The flows from the current system and the modified system are shown in Table 9. Based on these two projections, moving to the modified system on January 1, 1983 would save $1 billion over the first five years. While the cost savings during the early years would be moderate in relative terms they would grow significantly after the turn of the century as the Federal work force becomes predominantly covered by the new system. Ultimately, the savings would grow to nearly one-quarter of the current system's cost if it were to be perpetuated. The net savings estimates of moving to the modified system do not include any savings that could be realized if a Social Security windfall reduction provision for old hires were implemented. For example, Congressman Pickle, Chairman of the Social Security Subcommittee of the House Ways and Means Committee, has suggested legislation that would reduce windfalls in the future for individuals not covered by Social Security for some portion of their career. His proposal would reduce the benefit derived under the current formula to that percentage of total lifetime earnings in covered employment. If such a proposal were implemented in 1983 the total savings would be small. However, if one assumed that windfalls estimated in Table 3 were reduced at a rate of 2 percent per year the savings could be as much as $100 million by the mid 1980s and rise to more than $1 billion by the turn of the century. The Social Security actuaries have estimated similar savings. They estimated the Pickle proposal would save $100 million in both 1985 and 1986 and average .05 percent of total Social Security covered payrolls over the next 75 years.

Last year the Reagan Administration proposed a pension offset for workers who accrued a public pension in employment not covered by Social Security. This might reduce the windfalls for individuals retiring in the near future somewhat more rapidly than the Pickle proposal. There is a precedent now in the law that reduces Social Security spouse's benefits if they are receiving a noncovered benefit. Such offsets, however, are unpopular because people perceive them as a reduction in benefits to which they are entitled.

The net cost increase in the proposed system around the turn of the century shown in Table 9 is the result of modification to vesting provisions under the new plan. By that time, significant numbers of terminating workers will be rolling their vested benefits into alternative retirement vehicles as they leave Federal service. If the proposed modification of the new system were made in conjunction with a windfall reduction proposal the cost savings that would result from modifications to the CSRS would be significantly greater than those shown in Table 7.

The bottom line is that modifying the CSRS along the lines of the option analyzed here, or the Stevens' proposal, would result in significant budgetary savings over both the short and long run. Coverage of new hires under Social Security will maintain the level of employee contributions for retirement purposes. In a budgetary sense then, any proposal coupled with Social Security coverage that just maintains or slightly reduces total Federal retirement benefits cannot cost the taxpayers more than the current system. The actual numbers that would show up in the unified budget might be affected by moving accounts in or out of the budget. This would not affect taxpayer costs for Federal retirement, however.

GUARANTEEING THE VIABILITY OF CSRS

Current CSRS financing provisions assure that the retirement trust

fund will be sufficient to meet benefit obligations for the forseeable future. Modifying the system along the lines of the CSRS option discussed above, or the nearly identical Stevens' proposal, would change the internal arithmetic of CSRS funding. Both proposals would eliminate mandatory employee contributions to CSRS by workers covered under the new system. Furthermore, as current workers withdraw or retire the closed group contributions would also decline, as long as the system is open (i.e., new workers come into the system as old hires leave or retire). If the system is closed (i.e., new hires are not covered by the system) the new workers' contributions, the agency contributions and general revenue transfers on their behalf would dry up. Leaving the current workers and beneficiaries isolated in the closed system without contributions based on new workers' salaries would result in the depletion of the CSRS trust fund. Table 10 shows how this process would work if, in fact, CSRS were closed and current funding legislation were left in place. Somewhere around the turn of the century the CSRS trust fund would be depleted.

Technically this could be resolved very quickly by converting the unfunded liabilities for the closed group into formal debt. This would require the issuance of government IOUs (i.e., bonds or securities) in the amount of the unfunded obligations. This would require raising the government's formal debt limits while not changing its obligations. While the obligations are now unfunded they are defined by existing Federal pension statutes. The issuance of such IOUs would not change the current financial status (i.e., wealth) of the Federal Government at all. Each dollar of new debt (i.e., liabilities) that would result from such a transaction would also be a dollar of assets held by a governmental trust fund.

As a practical and political matter raising Federal debt limits at

once by the magnitude that would be required would be impossible. The creation of such a trust fund would certainly increase pressure for benefit liberalizations. It is also highly unlikely that the general public would acquiesce to such an increase in the formal Federal debt at once.

Senator Stevens has proposed forty-year amortization of the unfunded pension obligations for the workers who would continue to be covered by the old CSRS system. The long-run projections of trust fund income, payments and balances under this proposal are shown in Table 11. His proposal would provide for an adequate trust fund to meet all benefit obligations of the old system.

Table 12 provides a calculation of increased funding requirements under the Stevens' proposal. This funding modification would have different effects on the unified budget and the level of Federal debt.

The amortization of unfunded liabilities would have a neutral effect on the unified budget. Referring back to Figure 1, it is clear that this occurs because the transaction is all internal to the unified budget. The increased funding would show up as an increased expense in agency contributions or direct appropriations. It would be exactly offset as increased income to the internal CSRS account, however. The net effect is zero.

Since the increased funding would be accomplished through the issuance of new Federal securities, it would represent an increase in the formal Federal debt over the forty year amortization period. It would not represent an increase in actual liabilities, however. These liabilities already exist because of the benefit provisions defined in Federal statutes. The amortization of the statutory liabilities would merely recognize them as formal debt obligations to the trust fund. This would in no way affect the actual

benefit obligations under the plan.

The provisions in the Stevens' bill do appear to assure the long-term promises made to current workers and annuitants covered by CSRS. His proposal or a similar one would accomplish this without increasing the cost of Federal retirement program for the taxpayers.

TABLE 2

Projections of Existing Civil Service Retirement System
Future Budgetary Costs for Selected Years
(dollar amounts in billions)

	CSRS Payroll	CSRS Retirement Disability and Survivor Benefits	Employee Contributions Minus Refunds	Federal Agency and General Revenue Expenditures
1983	$60.1	$21.5	$3.6	$17.9
1984	65.5	23.9	3.9	20.0
1985	67.3	26.4	4.0	22.4
1986	77.5	28.9	4.6	24.3
1987	83.4	31.3	5.0	26.3
1988	89.0	33.7	5.3	28.4
1989	94.5	35.9	5.6	30.3
1990	99.8	38.2	5.9	32.3
1991	104.7	40.3	6.1	34.2
1995	132.3	50.1	7.7	42.4
2000	172.3	64.5	10.0	54.5
2005	230.4	84.3	13.5	70.8
2010	301.5	110.9	17.7	93.2
2015	404.7	146.2	23.8	122.4
2020	533.9	193.2	31.4	161.8
2025	699.4	253.9	41.3	212.6
2030	914.6	331.7	54.0	277.7
2035	1,195.4	430.5	70.5	360.0
2040	1,562.3	557.9	92.2	465.7
2045	2,041.9	724.6	120.5	604.1
2050	2,668.7	944.2	157.5	786.7

SOURCE: These projections were developed by Edwin C. Hustead, FSA, former Chief Actuary of the Civil Service Retirement System; he is now Director, Actuarial Consulting Services, Hay Associates.

TABLE 3

Projections of Future Costs for Existing CSRS and Social Security Windfalls for Federal Employees for Selected Years
(dollar amounts in billions)

	Agency and General 1/ Revenue Costs of CSRS	Social Security Windfall 2/ Benefits for CSRS Participants	Total Cost
1983	17.9	1.3	19.2
1984	20.0	1.4	21.4
1985	22.4	1.5	23.9
1986	24.3	1.6	25.9
1987	26.3	1.7	28.0
1988	28.4	1.8	30.2
1989	30.3	1.9	32.2
1990	32.3	1.9	34.2
1991	34.2	2.0	36.2
1995	42.4	2.5	44.9
2000	54.5	3.0	57.5
2005	70.8	3.7	74.5
2010	93.2	4.4	97.6
2015	122.4	5.4	127.8
2020	161.8	6.6	168.4
2025	212.6	8.0	220.6
2030	277.7	9.7	287.4
2035	360.0	11.8	371.8
2040	465.7	14.4	480.1
2045	604.1	17.5	621.6
2050	786.7	21.3	808.0

1/ From Table 2
2/ Estimated by the author; assumptions described in the text.

TABLE 4

Budgetary Flows for Closed CSR System Account 1/
(dollar amounts in billions)

Year	Retirement, Survivor and Disability Benefits	Refunds	Employee Contributions	Total Federal Agency and General Revenue Expenditures
1983	$21.5	$0.6	$4.0	$18.0
1984	24.0	0.6	4.1	20.5
1985	26.4	0.6	3.7	23.3
1986	28.9	0.6	4.1	25.4
1987	31.3	0.7	4.0	27.9
1988	33.7	0.7	3.9	30.4
1989	35.9	0.7	3.9	32.8
1990	38.0	0.7	3.6	35.1
1991	40.2	0.7	3.4	37.5
1995	49.5	0.6	2.2	47.9
2000	62.7	0.0	1.4	61.3
2005	78.1	0.0	1.2	76.8
2010	94.1	0.0	0.0	94.1
2015	104.6	0.0	0.0	104.6
2020	105.9	0.0	0.0	105.9
2025	99.4	0.0	0.0	99.4
2030	86.1	0.0	0.0	86.1
2035	67.3	0.0	0.0	67.3
2040	44.4	0.0	0.0	44.4
2045	25.0	0.0	0.0	25.0
2050	10.7	0.0	0.0	10.7

SOURCE: These projections were developed by Edwin C. Hustead, FSA, former Chief Actuary of the Civil Service Retirement System; he is now Director, Actuarial Consulting Services, Hay Associates.

1/ The system is described as "closed" because it is assumed that no new Federal employees hired after January 1, 1983 would participate in, contribute to or receive benefits from the current system. They would be participants in the modified system.

TABLE 5

Budgetary Flows for New Hires CSRS Account
(dollar amounts in billions)

Year	Retirement, Survivor and Disability Benefits	Refunds	Employee Contributions	Total Federal Agency and General Revenue Expenditures
1983	$0.0	$0.0	$0.1	($0.1)
1984	0.0	0.1	0.2	(0.1)
1985	0.0	0.3	0.4	(0.1)
1986	0.0	0.5	0.6	(0.1)
1987	0.0	0.7	0.8	(0.1)
1988	0.0	0.9	1.0	(0.1)
1989	0.0	1.2	1.2	0.0
1990	0.0	1.6	1.5	0.1
1991	0.1	1.9	1.7	0.3
1995	0.1	3.5	3.0	0.6
2000	0.3	7.8	4.6	3.5
2005	1.1	10.1	6.4	4.8
2010	6.2	13.2	9.0	10.4
2015	16.1	17.4	12.1	21.4
2020	36.6	23.0	16.0	43.6
2025	67.2	29.5	21.0	75.7
2030	110.5	38.6	27.4	121.7
2035	165.9	50.4	35.9	180.4
2040	239.1	65.8	46.9	258.0
2045	330.6	86.0	61.3	355.3
2050	439.4	112.4	80.1	471.7

1/ Amounts in parentheses are negative.

SOURCE: These projections were developed by Edwin C. Hustead, FSA, former Chief Actuary of the Civil Service Retirement System; he is now Director, Actuarial Consulting Services, Hay Associates.

TABLE 6

Federal Agency and General Revenue Expenditures
Projections for the Modified CSR System
(dollar amounts in billions)

Year	Combined CSRS Benefits	Combined Refunds	Combined Employee Contributions	Federal Agency and General Revenue Expenditures
1983	$21.5	$0.6	$4.2	$18.0
1984	24.0	0.7	4.3	20.4
1985	26.4	0.9	4.2	23.2
1986	28.9	1.1	4.7	25.4
1987	31.3	1.4	4.8	27.9
1988	33.7	1.6	4.9	30.3
1989	35.9	1.9	5.0	32.8
1990	38.0	2.3	5.0	35.3
1991	40.3	2.6	5.1	37.8
1995	49.6	4.1	5.2	48.5
2000	63.0	7.8	6.0	64.9
2005	79.2	10.1	7.6	81.6
2010	100.3	13.2	9.0	104.5
2015	120.7	17.4	12.1	126.0
2020	142.5	23.0	16.0	149.5
2025	166.6	29.5	21.0	175.1
2030	196.6	38.6	27.4	207.8
2035	233.2	50.4	35.9	247.7
2040	283.5	65.8	46.9	302.5
2045	355.6	86.0	61.3	380.3
2050	450.1	112.4	80.1	482.5

SOURCES: Tables 4 and 5.

TABLE 7

Social Security Account Contribution and Benefit Payment Increases and Budgetary Cost From Covering New Employees Under Social Security (dollar amounts in billions)

Year	Contributions 1/ Employer	Employee	Increased OASDHI Benefits	Net Social Security Revenue Increases 2/	Net Budget Cost or (Gain)
1983	$0.2	$0.2	$0.0	$0.4	($0.2)
1984	0.5	0.5	0.0	1.0	(0.5)
1985	1.0	1.0	0.0	2.0	(1.0)
1986	1.3	1.3	0.0	2.6	(1.3)
1987	1.8	1.8	0.0	3.6	(1.8)
1988	2.3	2.3	0.0	4.6	(2.3)
1989	2.8	2.8	0.0	5.6	(2.8)
1990	3.6	3.6	0.1	7.1	(3.5)
1991	4.2	4.2	0.1	8.3	(4.1)
1995	7.3	7.3	0.4	14.2	(6.9)
2000	11.0	11.0	0.8	21.2	(10.2)
2005	15.5	15.5	2.0	29.0	(13.5)
2010	21.9	21.9	3.5	40.3	(18.4)
2015	29.4	29.4	6.3	52.5	(23.1)
2020	38.8	38.8	20.1	57.5	(18.7)
2025	50.8	50.8	43.0	58.6	(7.8)
2030	66.5	66.5	70.5	62.5	4.0
2035	86.9	86.9	112.8	61.0	25.9
2040	113.5	113.5	171.3	55.7	57.8
2045	148.4	148.4	267.3	29.5	118.9
2050	193.9	193.9	395.0	(7.2)	201.1

1/ Assumes that 98 percent of total payroll of new hires is below Social Security maximum taxable earnings during first ten years, declining to 95 percent over next 3 years. Currently legislated tax rates were used to calculate the contributions. Estimated payroll was provided by Edwin C. Hustead, FSA, former Chief Actuary of the Civil Service Retirement System; he is now Director, Actuarial Consulting Services, Hay Associates.
2/ Benefit estimates for 1983-1990, 2000, 2025 and 2050 are from the Social Security Administration. Estimates for remaining years were developed by the author.

TABLE 8

Federal Budget Flows Required to Meet Federal Civilian Retirement Cost Under Proposed Restructuring of the Current System
(dollar amounts in billions)

Year	Closed System Cost	Modified System Cost: Federal Retirement	Modified System Cost: Social Security	Net Budgetary Cost
1983	$18.0	($0.1)	($0.2)	$17.8
1984	20.5	(0.1)	(0.5)	19.9
1985	23.3	(0.1)	(1.0)	22.2
1986	25.4	(0.1)	(1.3)	24.1
1987	27.9	(0.1)	(1.8)	26.1
1988	30.4	(0.1)	(2.3)	28.0
1989	32.8	0.0	(2.8)	30.0
1990	35.1	0.1	(3.5)	31.7
1991	37.5	0.3	(4.1)	33.7
1995	47.9	0.6	(6.9)	41.6
2000	61.3	3.5	(10.2)	54.7
2005	76.8	4.8	(13.5)	68.1
2010	94.1	10.4	(18.4)	86.1
2015	104.6	21.4	(23.1)	102.9
2020	105.9	43.6	(18.7)	130.8
2025	99.4	75.7	(7.8)	167.3
2030	86.1	121.7	4.0	211.8
2035	67.3	180.4	25.9	273.6
2040	44.4	258.0	57.8	360.3
2045	25.0	355.3	118.9	499.2
2050	10.7	471.7	201.1	683.6

SOURCES: Tables 4,5, and 7.

TABLE 9

Federal Agency and General Revenue Expenditure Projections for the Current CSRS and Modified System in Conjunction with Newly Hired Workers Under Social Security (dollar amounts in billions)

	Current System	Modified System	Net Savings 1/
1983	$17.9	$17.7	$0.2
1984	20.0	19.9	0.1
1985	22.4	22.2	0.2
1986	24.3	24.1	0.2
1987	26.3	26.1	0.2
1988	28.4	28.1	0.3
1989	30.3	30.0	0.3
1990	32.3	31.7	0.6
1991	34.2	33.7	0.5
1995	42.4	41.6	0.8
2000	54.5	54.7	(0.2)
2005	70.8	68.1	2.7
2010	93.2	86.1	7.1
2015	122.4	102.9	19.5
2020	161.9	130.8	31.0
2025	212.6	167.3	45.3
2030	277.7	211.8	65.9
2035	360.0	273.6	86.4
2040	465.7	360.3	105.4
2045	604.1	499.2	104.9
2050	786.7	683.6	103.1

1/ Amounts in parentheses are negative.

SOURCES: Tables 2, 6, and 8.

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TABLE 10

CSRS Income, Benefits and Fund Balances: Closed System for Current Workers Under Existing Financing Legislation for Selected Years (dollar amounts in billions)

Year	Employee Contributions	Employer Contributions	Investment Income 1/	Benefits	Fund Balance 1/
1983	$ 4.0	$ 20.5	$ 6.7	$ 22.1	$ 103.2
1984	4.1	22.1	7.2	24.6	112.0
1985	3.7	23.3	7.7	27.0	119.7
1986	4.1	25.0	8.1	29.5	127.5
1987	4.0	26.3	8.5	32.0	134.4
1988	3.9	27.5	8.9	34.3	140.4
1989	3.8	28.5	9.1	36.5	145.2
1990	3.6	29.4	9.3	38.7	148.8
1991	3.4	30.4	9.4	40.9	151.1
1995	2.2	34.4	8.9	50.1	143.3
2000	1.4	41.1	6.5	62.7	94.1
2005	1.2	49.7	0.9	78.1	(10.7)
2010	0.0	58.9	(9.0)	94.1	(193.4)
2015	0.0	70.7	(23.7)	104.6	(453.2)
2020	0.0	83.1	(41.8)	105.9	(761.3)
2025	0.0	95.1	(61.3)	99.4	(1,087.1)
2030	0.0	105.8	(80.4)	86.1	(1,400.8)
2035	0.0	114.6	(97.4)	67.3	(1,673.4)
2040	0.0	120.7	(110.6)	44.4	(1,878.1)
2045	0.0	124.4	(119.3)	25.0	(2,007.6)
2050	0.0	126.1	(123.9)	10.7	(2,073.9)

1/ Amounts in parentheses are negative.

SOURCE: These projections were developed by Edwin C. Hustead, FSA, former Chief Actuary of the Civil Service Retirement System; he is now Director, Actuarial Consulting Services, Hay Associates.

TABLE 11

CSRS Income, Benefits and Fund Balances: Closed System for Current Workers Under Financing Proposed in Stevens' Legislative Proposal for Selected Years (dollar amounts in billions)

Year	Employee Contributions	Employer Contributions	Investment Income	Benefits	Fund Balance
1983	$ 4.0	$ 29.6	$ 6.7	$ 22.1	$112.3
1984	4.1	31.2	7.9	24.6	130.8
1985	3.7	31.5	9.0	27.0	148.1
1986	4.1	34.2	10.1	29.5	166.9
1987	4.0	35.5	11.2	32.0	185.7
1988	3.9	36.7	12.3	34.3	204.3
1989	3.8	37.7	13.3	36.5	222.5
1990	3.6	38.5	14.2	38.7	240.2
1991	3.4	39.1	15.1	40.9	257.0
1995	2.2	41.7	18.0	50.1	311.6
2000	1.4	49.5	21.3	62.7	363.7
2005	1.2	62.5	24.1	78.1	411.2
2010	0.0	76.2	26.9	94.1	456.8
2015	0.0	99.5	31.4	104.6	549.7
2020	0.0	130.1	43.8	105.9	798.5
2025	0.0	0.0	53.1	99.4	838.0
2030	0.0	0.0	39.0	86.1	603.3
2035	0.0	0.0	25.4	67.3	381.9
2040	0.0	0.0	14.1	44.4	204.7
2045	0.0	0.0	6.2	25.0	85.4
2050	0.0	0.0	1.7	10.7	19.0

SOURCE: These projections were developed by Edwin C. Hustead, FSA, Former Chief Actuary of the Civil Service Retirement System; he is now Director, Actuarial Consulting Services, Hay Associates.

TABLE 12

Employer Contributions to CSRS Under Current Legislation and Stevens' Proposal: Closed System for Current Workers for Selected Years (dollar amounts in billions)

Year	Current Financing Contributions	Stevens' Proposal Financing Contributions	Increased Funding Requirements 1/
1983	$20.5	$29.6	$9.1
1984	22.1	31.2	9.1
1985	23.3	31.5	8.2
1986	25.0	34.2	9.2
1987	26.3	35.5	9.2
1988	27.5	36.7	9.2
1989	28.5	37.7	9.2
1990	29.4	38.5	9.1
1991	30.4	39.1	8.7
1995	34.4	41.7	7.3
2000	41.1	45.9	8.4
2005	49.7	62.5	12.8
2010	58.9	76.2	17.3
2015	70.7	99.5	28.8
2020	83.1	130.1	47.0
2025	95.1	0.0	(95.1)
2030	105.8	0.0	(105.8)
2035	114.6	0.0	(114.6)
2040	120.7	0.0	(120.7)
2045	124.4	0.0	(124.4)
2050	126.1	0.0	(126.1)

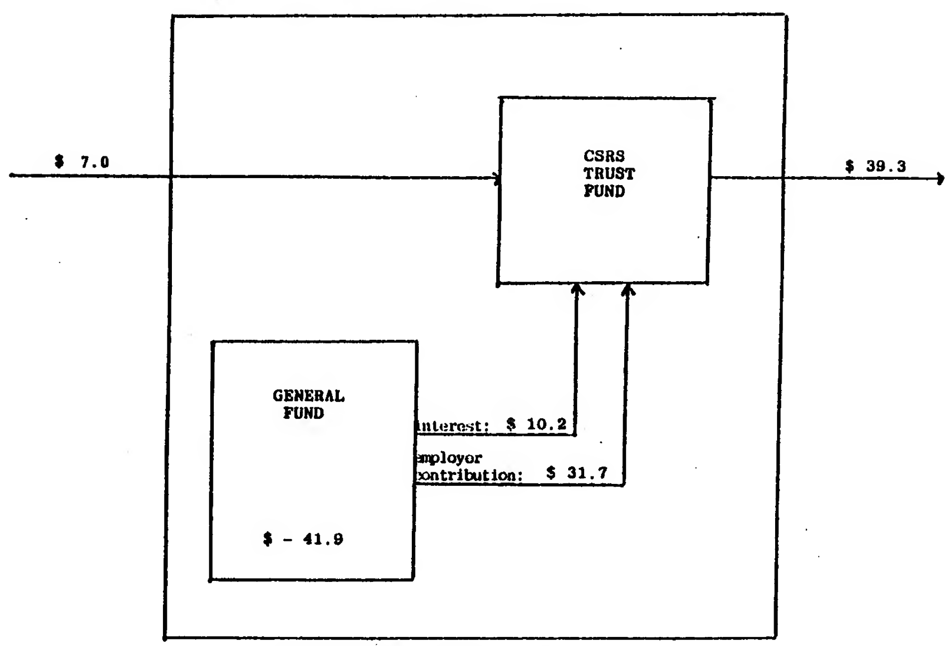
1/ Amounts in parentheses are negative.

SOURCE: These projections were developed by Edwin C. Hustead, FSA, former Chief Actuary of the Civil Service Retirement System; he is now Director, Actuarial Consulting Services, Hay Associates.

VII. BUDGETARY FLOW CHARTS

The impact on the federal budget as a result of our legislation is extremely complex. Sylvester Schieber of the Employee Benefit Research Institute in concert with the Senate Special Committee on Aging has diagrammed the budgetary impact of our legislation vis-a-vis the continuation of the current system. They chose four years to portray the various impacts on the budget, i.e. 1990, 2000, 2025, and 2050. The numbers are in billions of dollars. Beginning in the year 2000 and following, three diagrams are provided. The first shows the budgetary impact of maintaining the Current System, assuming no changes. The second portrays the impact of our legislation if all monies were retained in the federal treasury. It is entitled the Modified System—Internal Funding. The third diagram, entitled the Modified System—External and Internal Funding—portrays the budgetary impact of our legislation as currently drafted.

CURRENT SYSTEM; 1990



BUDGET EFFECT: Revenues: $ 7.0
Outlays: 39.3

NET: -32.3

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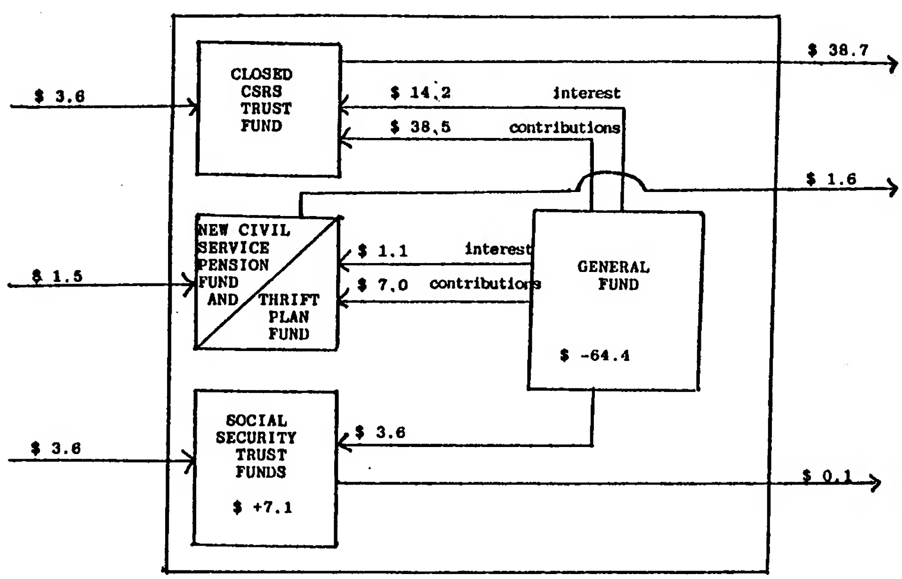
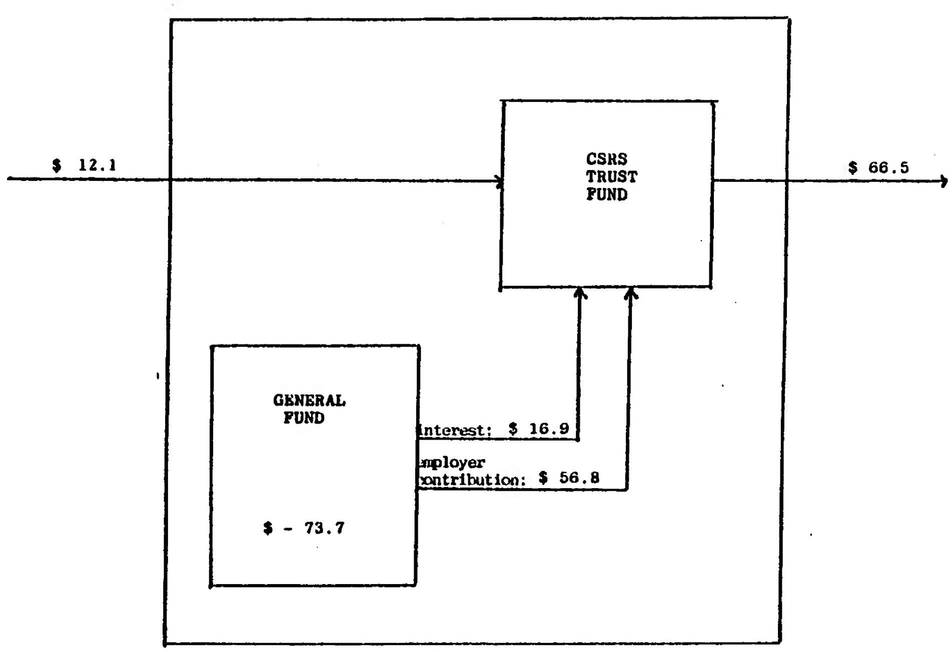
MODIFIED SYSTEM -
INTERNAL FUNDING: <u>1990</u>



BUDGET EFFECT: Revenues: $ 8.7
Outlays: 40.4

NET: -31.7

CURRENT SYSTEM: 2000



BUDGET EFFECT: Revenues: $ 12.1
Outlays: 66.5

NET: -54.5

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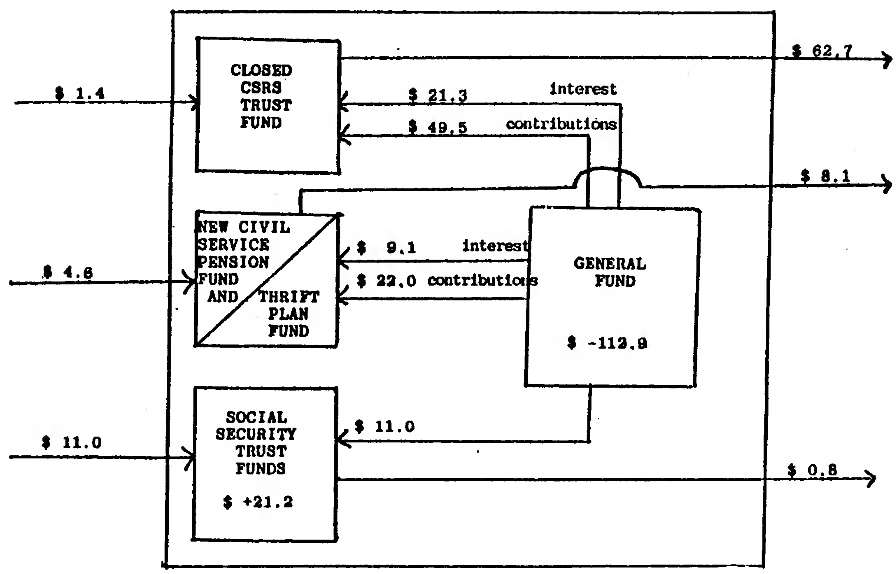
MODIFIED SYSTEM -
INTERNAL FUNDING: <u>2000</u>



BUDGET EFFECT: Revenues: $ 17.0
Outlays: 71.6

NET: -54.6

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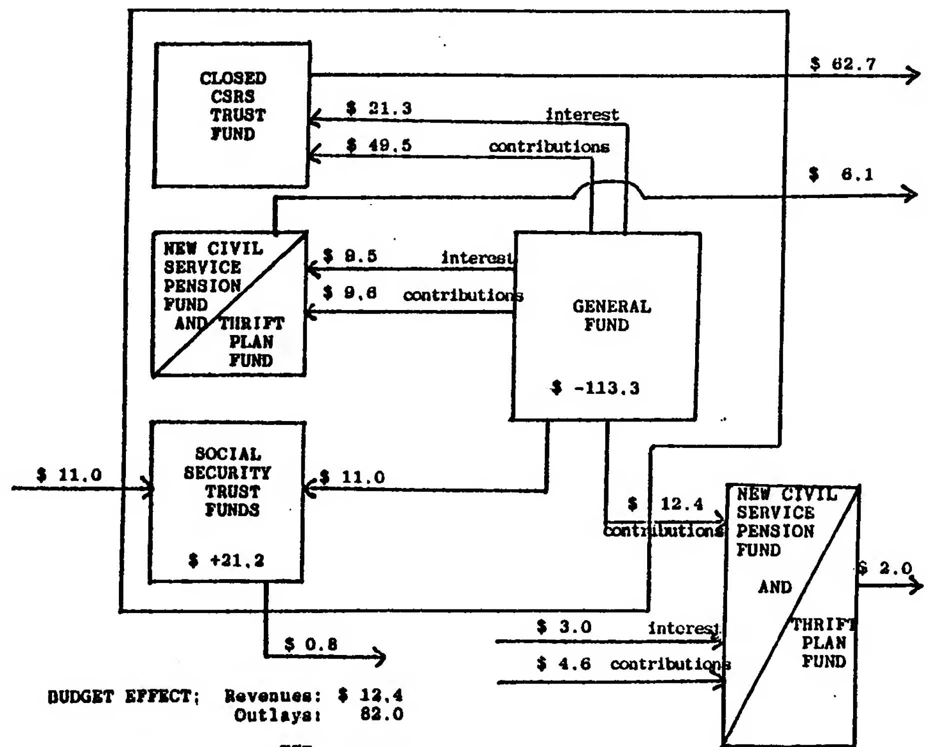
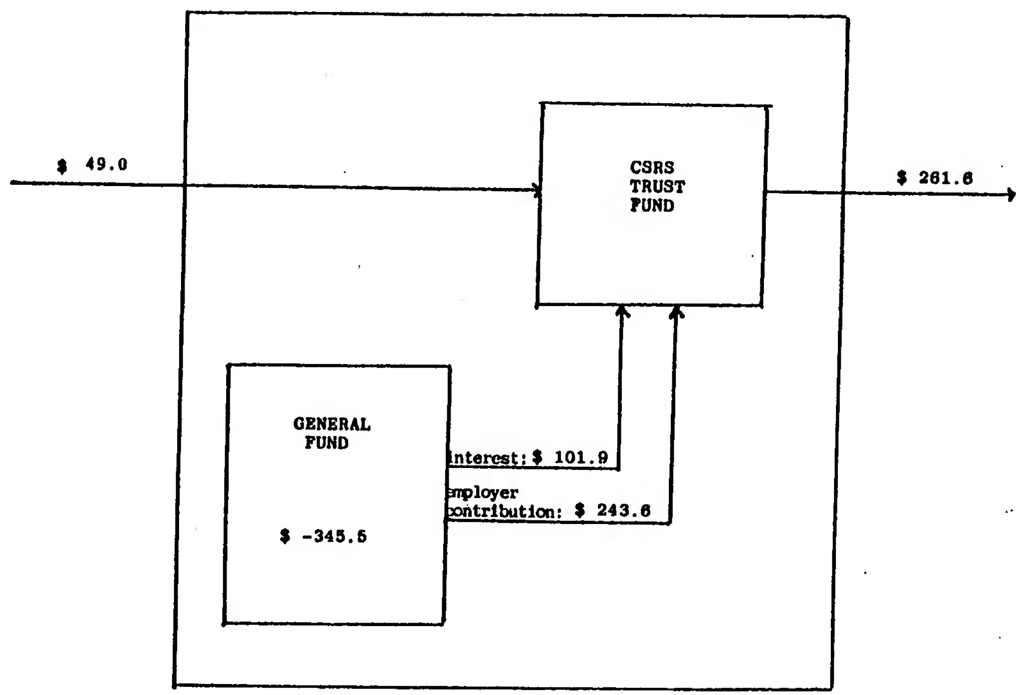
MODIFIED SYSTEM -
EXTERNAL AND INTERNAL FUNDING: 2000



BUDGET EFFECT: Revenues: $ 12.4
Outlays: 82.0
NET: - 69.6

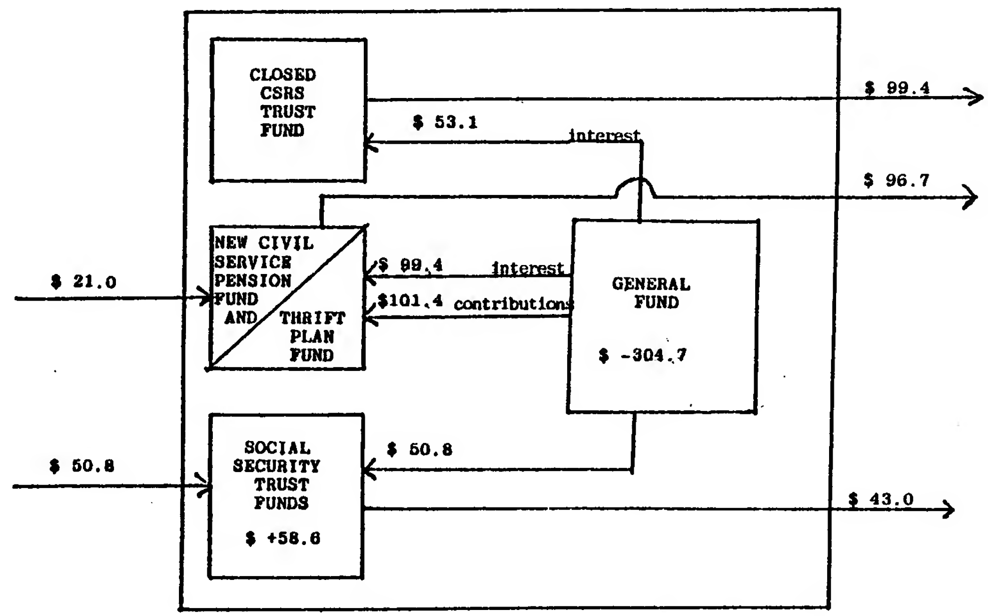
CURRENT SYSTEM; 2025



BUDGET EFFECT: Revenues: $ 49.0
Outlays: 261.6

NET: -212.6

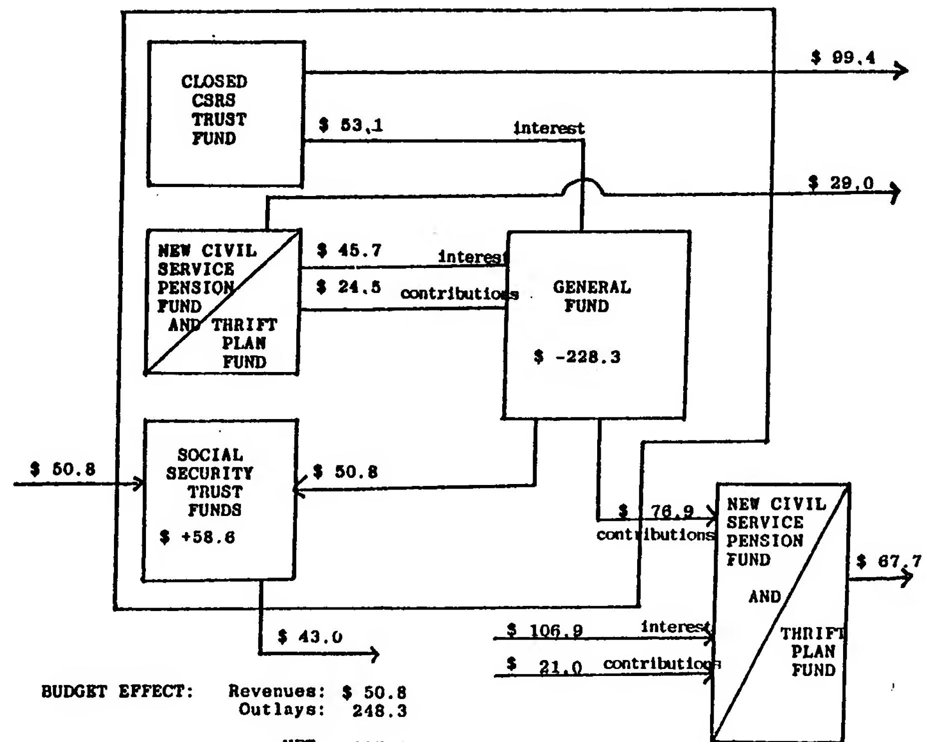
MODIFIED SYSTEM -
INTERNAL FUNDING; 2025



BUDGET EFFECT: Revenues; $ 71.8
Outlays: 239.1

NET: -167.3

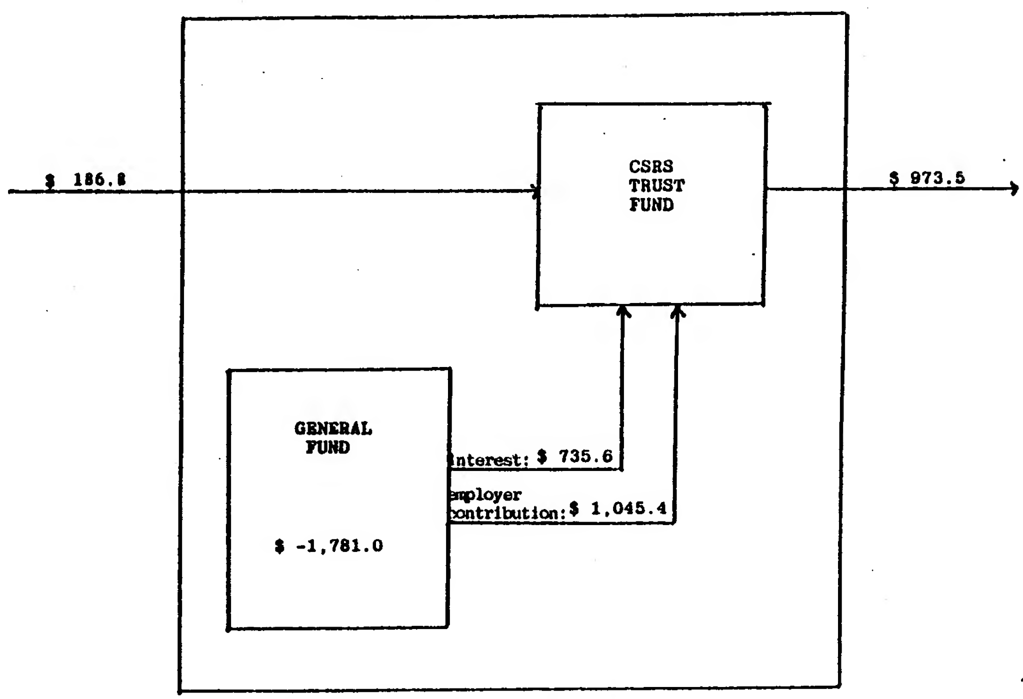
MODIFIED SYSTEM -
EXTERNAL AND INTERNAL FUNDING: 2025



BUDGET EFFECT: Revenues: $ 50.8
Outlays: 248.3

NET: -197.5

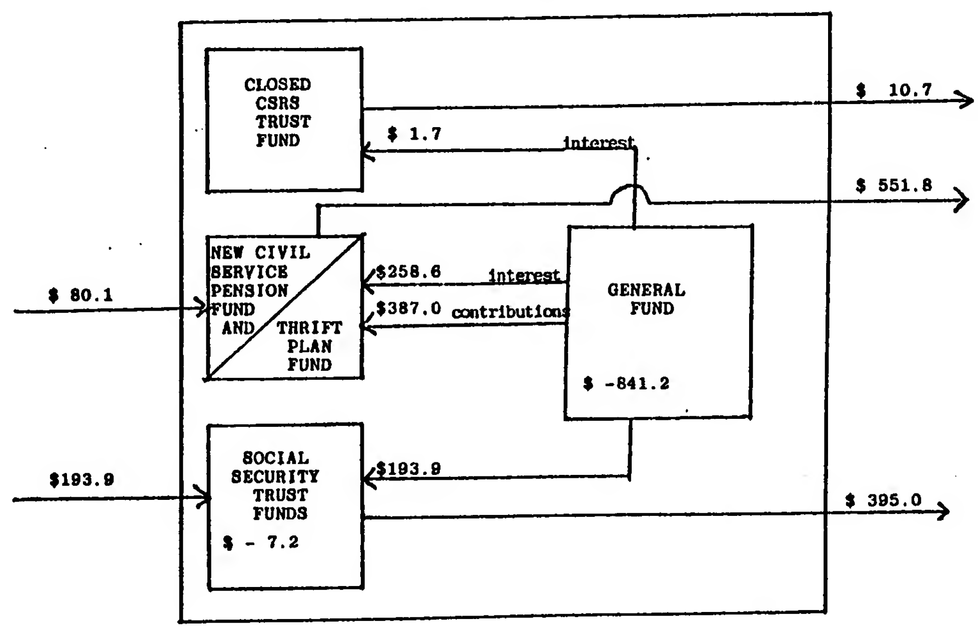
CURRENT SYSTEM; 2050



BUDGET EFFECT: Revenues: $186.8
Outlays: 973.5

NET: -786.7

MODIFIED SYSTEM -
INTERNAL FUNDING; 2050



BUDGET EFFECT: Revenues; $ 274.0
Outlays: 957.5

NET: -683.5

MODIFIED SYSTEM -
EXTERNAL AND INTERNAL FUNDING: 2050